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Senior Interagency Group No. 22

TO : OVP - Mrs. Nancy Bearg Dyke
 NSC - Mr. Michael Wheeler
 Agriculture - Mr. Raymond Lett
 CIA - Mr. Thomas B. Cormack
 Commerce - Ms. Jean Jones
 DOD - COL John Stanford
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 JCS - MAJ Dennis Stanley
 Treasury - Mr. David Pickford
 USTR - Mr. Richard Heimlich

SUBJECT: Notification of SIG Meeting: Eastern Europe Policy

A meeting of the SIG on Eastern Europe Policy (NSSD 5-82) will be held Monday, May 3, at 10:00 a.m. in the Deputy Secretary's Conference Room, 7219, at the State Department.

The SIG will review the proposed National Security Decision Directive (NSDD) which is attached. The SIG Memorandum and an Executive Summary, also attached, provide background to the NSDD.

Attendance will be principal plus one. Please telephone the names of your representatives to Mrs. Sheila Lopez, 632-5804, by 9:30 a.m., Monday, May 3.

L. Paul Bremer, III
 Executive Secretary

Attachments:

1. Proposed NSDD on Policy toward East Europe
2. Executive Summary of SIG Memorandum
3. SIG Memorandum

NSC review completed.

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State Dept. review completed

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National Security Decision
Directive Number

UNITED STATES POLICY TOWARD EASTERN EUROPE

I have reviewed the interagency report on United States policy toward Eastern Europe. I have determined that the primary long-term U.S. goal in Eastern Europe is to loosen the Soviet hold on the region and thereby facilitate its eventual reintegration into the European community of nations. Western influence in the region is limited by Moscow's willingness to use force against developments which threaten what it perceives as its vital interests in the region. Nevertheless, the United States can have an important impact on the region, provided it differentiates in its policies toward the Soviet Union and the Warsaw Pact countries of Eastern Europe, and among the countries of Eastern Europe, so as to encourage diversity through political and economic policies tailored to individual countries.

Differentiation will be aimed at:

- encouraging more liberal trends in the region;
- furthering human and civil rights in East European nations;
- reinforcing the pro-Western orientation of their peoples;
- loosening their economic and political dependence on the USSR and facilitating their association with the free nations of Western Europe;
- Undermining the military preparedness of the Warsaw Pact.

In implementing its policy, the U.S. will calibrate its policies to discriminate carefully in favor of governments which:

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- show relative independence from the Soviet Union in the conduct of foreign policy as manifested by the degree to which they resist associating themselves with Soviet foreign policy objectives and support or refrain from obstructing Western objectives; or
- show relatively greater internal liberalization as manifested in a willingness to observe internationally recognized human rights and to pursue a degree of pluralism and decentralization.

Conversely, states which fail to show internal or external independence should be treated essentially as we treat the USSR.

The U.S. Government will employ commercial, financial, exchange informational, and diplomatic instruments in implementing its policy toward Eastern Europe to include the following:

- Most-Favored-Nation (MFN) Status. MFN status will be exploited consistent with U.S. law and policy objectives, as an important and highly visible benefit of improved U.S. relations with Eastern European nations and a hallmark of our attitude toward them.
- Credit Policy. Access to private and official Western capital is a key asset for the economic development of Eastern Europe. The U.S. Government extends financing which benefits Eastern European countries through a number of programs. In deciding on the extension of such financing, we will take into account U. S. political and security objectives within the framework of U.S. law, agencies' regulations, and economic criteria.
- International Monetary Fund (IMF) membership. It has long been U.S. policy to support the membership in the IMF of any country which is prepared to accept the obligations of Fund membership. The U.S. will continue to place economic and financial factors first among other decision criteria when considering IMF membership in individual cases; we will also continue to judge applications on a case-by-case basis, giving due weight to political and security factors when considering whether countries, particularly those in Eastern Europe, can be expected to meet the obligations of Fund membership fully and without reserve.

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- Debt Rescheduling. U.S. policy is to extend debt relief only when it is necessary as a financial measure to ensure repayment and when the debtor country embarks on an economic/financial stabilization program designed to rectify the country's financial position. In addition to these financial criteria, political and security objectives will continue to be given due weight in reaching a final decision on rescheduling the debts of Eastern European countries.
- Technology Transfer and Export Controls. U.S. strategic concern will remain paramount. A cautious policy of export control differentiation, reached in cooperation with our allies, should be an important facet of our policy towards Eastern Europe.
- Cultural and Educational Exchange and Informational Programs. Such programs will be employed to reinforce the pro-Western orientation of the populace in Eastern Europe, and communicate U.S. views to publics there.
- Scientific Exchanges. Through exchanges and increased interactions, the USG will continue to work to reinforce the Western orientation of the countries' scientific- technical elites. Scientific exchanges will continue to be subject to our strategic concerns with technology transfer.
- High Level Visits, Ship Visits and Consultations. Such actions provide an opportunity to show U.S. support -- or by their absence, lack of support -- for an individual country's policies.
- International Organizations. International fora will be exploited particularly for negative differentiation, to focus world attention on actions by the Soviet Union and Eastern European states which violate internationally recognized human rights or norms of international behavior.
- Restrictions on Eastern European Diplomats and Consular Personnel. Restrictions provide a means of regulating the number and activities of Eastern European diplomats in the United States in accordance with our approval or disapproval of the sending country's actions. Use of this tool will be considered in the context of reciprocal actions and their impact upon U.S. security and other interests.

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U.S. POLICY TOWARD EASTERN EUROPE

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- II. U.S. Policy Toward Eastern Europe: Overview Paper
- III. The Balance Sheet of Differentiation
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 - D. Concessional Sales of Foodstuffs
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 - G. Commercial Policy as an Instrument of Differentiation
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EXECUTIVE SUMMARY

In accordance with the President's Directive of March 25, an Interagency Group examined U.S. Policy Toward Eastern Europe. It is the Group's opinion that the primary long-term U.S. goal in Eastern Europe is to loosen Moscow's hold on the region, thereby leading to its eventual reintegration into the European community. The Group recognizes that Western influence in the region is limited by Moscow's willingness to use force against developments which threaten its vital interests (e.g., East Berlin, 1953; Hungary, 1956; Czechoslovakia, 1968; and Poland, 1981). Nevertheless, the Group feels that the USG can have an important impact on the region, provided it differentiates in its policies toward the Soviet Union and the Warsaw Pact countries of Eastern Europe and among the East European States, by encouraging diversity through active political and economic policies tailored to individual countries. For example, a policy of differentiation could:

- encourage liberalizing trends in the region,
- increase the region's economic dependence on the U.S.,
- help advance human rights concerns,
- reinforce the already existing pro-Western orientation of the populace in Eastern Europe,
- adversely impact on Warsaw Pact military offensive capabilities in Europe.

The Group also reviewed an alternative policy of non-differentiation which would call upon the USG and our Allies to minimize political and economic contacts with the region. The Group rejected this approach on the grounds that such a policy would seriously limit Eastern Europe's freedom of action vis-a-vis the USSR and result in increased Soviet hegemony over the region.

In implementing a policy of differentiation, the Group agreed that the U.S. should follow a course of carefully discriminating in favor of countries which:

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-- show relative independence from the Soviet Union in the conduct of foreign policy as manifested in the degree to which they resist associating themselves with Soviet foreign policy objectives and support or refrain from obstructing Western objectives; or

-- show a greater degree of internal liberalization as expressed in a willingness to observe internationally recognized human rights, and a degree of pluralism and decentralization in the political and economic spheres.

It was also the Group's conclusion that states which fail to show internal or external independence should be treated essentially as we treat the USSR. The Group also concluded that to be effective, a policy of differentiation must be carefully calibrated. For example, those countries less involved in support of Soviet foreign policy should be treated more favorably than those which vigorously back up Moscow in its policies around the world. Instruments for implementing differentiation include:

- Most Favord Nation Status
- Granting of Credits
- IMF Membership
- Concessional Sales of Foodstuffs
- Debt Rescheduling
- Technology Transfer
- Cultural and Scholarly Policies and Information Policies
- Scientific Exchanges
- High Level Visits, Ship Visits, Consultations
- Activities in International Fora
- Restrictions on Eastern European Diplomatic and Consular Personnel.

Finally, the Group noted that in the past too little attention has been focused on negative differentiation. To be credible, those countries which do not show visible signs of progress should be penalized. We must not assume that U.S. concessions will of themselves lring about greater independence on the part of these countries. Such rewards must be earned.

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OVERVIEW PAPERPreambular Statement

The purpose of this study is to review U.S. policy toward Eastern Europe. It will determine whether or not the United States should continue to differentiate in its policies between the countries of Eastern Europe and the Soviet Union and among the countries of Eastern Europe. If the answer is affirmative, the Review will define to what end such a policy is to be pursued and by what instrumentalities. The study will provide policy recommendations for achieving our objectives for consideration by the National Security Council and, subsequently, for decision by the President.

I. The Problem

Is the primary long-term objective of U.S. policy toward Eastern Europe to encourage processes which, in time, may loosen Moscow's hold on the region and lead to its reintegration into the European community or is it to maintain regional stability in order to prevent the area from turning into a potential cause of East-West confrontation? Two long-term approaches have been suggested to achieve these two different goals.

II. The Policy of Differentiation

The policy of differentiation argues that the U.S. should differentiate in its policies toward the Soviet Union and the Warsaw Pact countries of Eastern Europe, and between the countries of Eastern Europe, by encouraging diversity through active political and economic policies tailored to individual countries. Those who favor this policy point to the strong and enduring pro-Western bias of most East European populations, which has easily survived thirty-four years of communist rule. They argue that this desire for closer economic, political and cultural ties with the West can be exploited to weaken the USSR and that we should:

-- encourage liberalizing tendencies in the region. Increased pluralism will make it more difficult for the Soviets to exert political control over the region. Moscow will face continuing problems in enforcing ideological orthodoxy if the internal policies of the countries of Eastern Europe differ

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significantly. Likewise, in the foreign policy area, the Soviets will find it more difficult to muster the support of their Warsaw Pact allies on issues of importance. For example, the Warsaw Pact requires unanimous approval for a document to receive Pact approval. Refusal by one or more members to endorse a policy document forces the Soviets either to modify their position or do without the Pact's imprimatur.

-- increase economic dependence of Eastern European countries on the West. Eastern European trade with the West has led to varying but important degrees of dependence on the continuation of these economic ties. This dependence offers opportunities to exert leverage on the affected countries. In addition, ties with the West open up a freer flow of ideas through exchanges and increased interactions thereby intensifying the Western orientation of the region's elites. The need for Western supplies, replacement parts, markets, etc., contributes to a gradual reorientation of the East European economies toward the West. At the same time, care must be taken in adopting trade and credit policies to ensure that we and our allies do not develop an economic dependence on the East Europeans or subsidize Warsaw Pact developments or imports, and do not unduly relieve Soviet responsibility, for the East European economic problems.

-- expose the region to demands for better human rights performance. By making some of the rewards these countries seek dependent on respect for internationally recognized human rights, Western leverage in this important area will be increased. Without differentiation, Western influence in this area would be almost non-existent.

-- increase antagonism between Moscow and some of the East European states. Given Moscow's concern over East European ties with the West, and the desire of these countries to intensify or expand them, the East's reaction to a policy of differentiation will be a potential source of disagreement within the Pact.

-- weaken the Warsaw Pact as a unified military institution. Western political-economic ties may also undermine the USSR's ability to instill a strong fighting spirit vis-a-vis NATO in the minds of those soldiers whose countries have strong ties with the West. Overall Pact military preparedness vis-a-vis NATO could be affected.

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II. A Policy of Non-Differentiation

Those who favor a policy of non-differentiation call on the USG and its allies to minimize political and economic contacts with the region. Proponents of this approach argue that it would, over time, weaken the USSR by:

-- increasing strains within the Pact and forcing diversion of resources away from military uses. Given the demonstrated economic inefficiency of Communist states and their inability to satisfy consumer demands, a sharp decrease in political and economic contacts with the West would cause a drop in living standards, especially if the USSR attempts to maintain military spending at current levels. This could result in an increase of unrest in Eastern Europe and, despite (or because of) increased police suppression, ultimately force the Soviets to allocate greater amounts of their scarce economic resources to supplying the area with raw materials, food and consumer goods. It is argued that such expenditures will decrease resources available for building up the Soviet military. While potentially dangerous, the interim instability is judged not to be a serious threat to peace in Europe, and is justified by the longer-run prospect of a weakened USSR.

-- helping to stem the flow of Western technology to the USSR. By placing the same restrictions on exports to Moscow's Eastern European allies as those now in force against the USSR and, by persuading our allies to cooperate, we might significantly slow Soviet development in many technical fields.

-- weakening the appeal of communism in the West. A deterioration in the quality of life and harsher police regimes in the Soviet-imposed systems in Eastern Europe, accentuated by periodic explosions of public unrest, would cause Marxism-Leninism to lose much of whatever allure it retains as an ideology in the West. The same phenomena, while feeding anxieties in some sectors of Western European opinion, would result in a greater willingness on the part of the Western public to support increased defense expenditures.

III. Evaluating U.S. Policy Toward Eastern Europe

A. The Interagency Group has carefully reviewed both of these approaches and the problems facing the USG in the region. It is the Group's opinion that the primary U.S. long-term goal in Eastern Europe is to loosen Moscow's hold on the region, thereby leading to its eventual reintegration into the European community. The Group recognizes that differentiation is not

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likely to lead to a collapse of Soviet influence in Eastern Europe since Moscow can be expected to continue to act to oppose developments in the region which it believes threaten its vital interests (e.g., East Berlin, 1953; Hungary, 1956; Czechoslovakia, 1968; and Poland, 1981). Nevertheless, it is the Group's judgment that while the impact of differentiation may be marginal in some cases it offers the best vehicle for achieving the primary U.S. goal of lessening overall Soviet control in the region. This judgment is based on the following factors:

-- despite the setback in Poland, the policy of differentiation has had an important impact on the region. For example, American -- and West European -- policies of encouraging diversity and close ties with the West through our economic and cultural policies helped facilitate the rise of Solidarity. Furthermore, the Polish government's crackdown does not demonstrate that the Soviet Union will not permit liberalizing trends in the region, only that it cannot accept such changes if they threaten to destroy the Communist Party's leading role or take a country out of the Warsaw Pact. Although the experiment of greater openness and democracy which accompanied the rise of Solidarity has been crushed by the government, it has had a cataclysmic impact on the Soviet Empire, and its effects will linger on for years to come. At the same time, we must keep in mind that in the aftermath of the Polish events, Soviet tolerance for liberalization may have lessened, out of fear that small reforms will lead to big ones. If true, the impact of our policy could be somewhat lessened in the immediate future.

-- As a result of the policy of differentiation the U.S. has followed vis-a-vis Eastern Europe in recent years, the economic dependency on the U.S. of some of the countries in that region has reached the point where we are in a position to seriously hurt them. For example, the sanctions imposed by the President on December 23 have seriously exacerbated Poland's grave economic difficulties. As a result, our ability to influence the actions of the Warsaw government -- while still limited -- is greater than it would be otherwise. It should be noted, however, that if these countries make up their minds to resist Western pressures regardless of the costs to their economies, they have the ability to do so. The Group does not think that minimizing economic ties with the region will force the Soviets to divert funds from military purposes in order to maintain stability in the region. For under far worse economic conditions prevailing in the past in the Soviet Union (and in Eastern Europe), Moscow never hesitated to give its military programs the highest priority.

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-- while some transfer of American technology to the Soviet Union occurs via Eastern Europe, this is not the only source of the problem. Our major task is to cut-off the illegal transfer of technology which occurs either through overseas intermediaries, or as a result of outright theft in this country and abroad.

-- Despite the danger that differentiation could reduce to some degree Western awareness of the "communist" rather than merely Soviet danger to the West, one of the primary goals of the U.S. is to build as wide a coalition as possible against Soviet expansionism. If China, Yugoslavia, or Romania share our concern about Soviet "hegemonism," then it is in the U.S. national interest to coopt them and cooperate with them. We know, and they know, that our other interests are not identical and our cooperation is thus limited. But if we reject them altogether, we weaken our cause and hence strengthen the Soviet Union.

-- If a policy is adopted which treats all East European states alike, countries which have or have had the most extensive ties to the West and have shown some reluctance to follow the Soviet model, would be penalized the most. When countries like Cuba or Vietnam act on behalf of Moscow, there is every reason to treat them the same way as the USSR. A thorough and careful analysis of the recent policies of the GDR and Czechoslovakia may offer the conclusion that they, too, fall in the category of Soviet proxies. As to the other party-states in Eastern Europe, the pressure upon them to become stronger Soviet proxies will increase sharply if their present disinclination to support Soviet foreign policy or duplicate Soviet domestic practices is not supported by Western policies.

-- differentiation minimizes the danger of friction with our Allies, who will be vital for us in implementing any policy vis-a-vis the region. If we attempted to seriously cut-back our ties with the region, many if not most of our Allies would refuse to cooperate with us or provide only limited support. Without Western European cooperation, we could not successfully isolate Eastern Europe.

-- differentiation has helped advance human rights concerns in the region. If we treated all Eastern European states alike, our ability to influence human rights policies would be severely hampered. In the past, we have been able to gain concessions from countries such as Romania and Poland on human rights issues in return for favored treatment in other areas.

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-- the policy of differentiation especially in the area of cultural programs and exchanges has reinforced the already existing pro-Western orientation of the populace in Eastern Europe. If we treat the region as a bloc, East Europeans will perceive that they have been abandoned and will believe that they have no alternative but to make accommodations with the Soviets. As long as we continue to broaden and intensify cultural relations with those countries showing the most internal and external independence, there will continue to be popular, albeit limited, pressure on the regimes in this region to provide more openings to the West.

-- The policy of differentiation had an adverse impact on Warsaw Pact military preparedness. While other factors also played an important role, Western rewards for Romanian independence from the Soviet Union reinforced Ceausescu's willingness to refuse to increase military spending (supported indirectly by other Pact members) and oppose closer Pact integration. Both of those actions have hampered Moscow's ability to strengthen the Pact's combat readiness. Furthermore, increased ties with the West have strengthened the pro-Western orientation of the populace and developments such as the rise of Solidarity not only made the willingness of Polish soldiers to fight a "Soviet war" more problematical, they also tie the Polish army down dealing with internal developments thereby reducing the time available to them for training for a confrontation with NATO.

The Interagency Group rejects the suggestion by some Western Europeans that the U.S. should make only minimal efforts to weaken the Soviet hold on the region. The Group believes that loosening the Soviet hold on Eastern Europe is the principal objective of U.S. policy, and that the problems raised by West Europeans are manageable.

B. In implementing differentiation, the Interagency Group agreed that the U.S. should follow a course of carefully distinguishing in favor of those countries which:

-- show relative independence from the Soviet Union in the conduct of foreign policy as manifested in the degree to which they resist associating themselves with Soviet foreign policy objectives and support or refrain from obstructing Western objectives. In determining whether or not a given East European country meets or fails to meet these standards, criteria such as the following will be used:

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--the degree to which a country withholds support for Soviet foreign policy initiatives;

--the degree to which a country grants support for Soviet actions against other East European states;

--the intensity of its support for Moscow on issues such as defense budget increases and Pact integration;

--the extent and nature of its support for Soviet actions in the third world;

--its willingness to dissociate itself from Soviet-sponsored acts of terrorism.

-- show a greater degree of internal liberalization as expressed in a willingness to observe internationally recognized human rights, and a degree of pluralism and decentralization in the political and economic spheres. Examples of actions in this area include:

--a willingness to observe internationally recognized human rights including the freedom of emigration and religion, and ethnic tolerance;

--movement toward economic decentralization and the tolerance of a private sector in agriculture and trade;

--acceptance of trade union activity.

The Interagency Group also agreed that those states which fail to show internal or external independence should be penalized. It was also decided that to be effective, such a policy should be carefully calibrated. For example, countries like Hungary which are less involved in supporting Soviet policy in the Third World through substantial military aid and training programs, should be treated perceptibly more favorably than those like the GDR which are deeply involved in the military-security area.

The Group noted that in some instances credits can be extended to Eastern European countries or a more flexible

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export policy implemented even if it can be shown that the Soviet Union could benefit marginally from the transaction through a diminution in demand on its resources. The criterion should be whether there is a demonstrable benefit to the West from the transaction and a net loss to the Soviets in terms of their political and economic control over the Eastern European country involved. In other words, transactions of this sort are not always necessarily a zero-sum game; they are proper subjects of cost-benefit analysis.

Finally, the Interagency Group noted that in the past too little attention has been focused on negative differentiation. To be credible, a policy of differentiation should visibly penalize those countries which do not show progress in the direction of internal or external independence. It cannot be assumed that U.S. concessions will bring about greater independence on the part of these countries. Such rewards must be earned.

IV. Recommendation

That the U.S. Government follow a policy of differentiation (as defined above) in its relations with the states of Eastern Europe. In implementing such a policy, the USG should reward those countries which exhibit either relative external independence from the Soviet Union in their foreign policies or show a greater degree of liberalization in their internal policies. Likewise, those states which fail to show internal and external independence should be penalized.

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III. THE BALANCE SHEET OF DIFFERENTIATION

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The policy of differentiation has been a contributing factor toward weakening Soviet control over Eastern Europe, and has thus been a net asset in our policy toward the Soviet Union. By loosening the East European countries' economic dependence on the USSR, by cultivating pro-Western attitudes among publics and elites, and by encouraging steps toward national approaches and political liberalization, differentiation has helped to increase Soviet acquiescence in a greater degree of diversity within Eastern Europe (as long as Communist Party control has remained assured). To some extent, this acquiescence is attributable to the complexity of indigenous in Eastern Europe and Moscow's realization of the adverse impact and intolerant approach would have on its overall international position. But, on balance, differentiation has been a factor for restraint in Soviet policy, particularly during periods of reduced strains in the U.S.-Soviet relationship. At other times, it has not restrained Moscow as in Czechoslovakia in 1968.

Political Impact on US-Soviet Relations: The policy of differentiation has not historically posed an obstacle to efforts to improve U.S.-Soviet relations. The Soviets have, to varying degrees, tolerated the expansion by the West of economic and exchange relationships with the East European countries, as the result of: economic necessity; the attraction of letting the West bear some of the burden of East European development; acceptance of the need for a safety valve to avert a recurrence of the explosions of the 1950s that the Stalinist system had produced; and a recognition that sacrificing absolute control over the bloc was the necessary price for an improvement in the USSR's own economic and political relationships with Western countries. The Soviets felt confident throughout the 1960s and 1970s that the fundamental Western objective was no longer to overturn Communist rule in Eastern Europe, and that improved Western ties with the East Europeans would not prevent Moscow, in extremis, from intervening to ensure Communist Party control when internal pressures had undermined the local regime's position, as in Czechoslovakia. In fact, the minimal Western response to the 1968 invasion must have reinforced Moscow's perception that differentiation, while an undesirable encroachment on Soviet authority in Eastern Europe, was not a threat to the USSR's strategic interests.

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The recent events in Poland represent the first case in recent years where Western policies of differentiation have become an openly contentious issue in U.S.-Soviet relations. The Soviets recognize that it was mistakes by the Gierek regime and the adverse economic conditions in Poland which brought about the strikes of August 1980 and the discrediting of the Polish Communist Party. But they also recognize that Gierek's conscious effort to orient Poland's economy Westward, and the attendant exposure of Polish society to Western influence, helped lay the seeds for Solidarity's challenge to Party rule. Moreover, the Soviets profess to see -- and probably do in fact see -- Western efforts to link debt rescheduling and other economic assistance to pluralistic development in Poland as an attempt at exploiting that country's increased dependence on the West in order to steer it toward Social Democracy and, ultimately, to undermine Poland's alliance with the USSR.

Western countries' imposition of sanctions following the declaration of martial law, and U.S. insistence that improved U.S.-Soviet relations will be difficult to achieve as long as the repression continues, may have prompted Moscow to question whether the price of tolerating differentiated policies is too great in terms of the threat to Soviet control in Eastern Europe. Thus far, however, the Soviets have continued to seek expanded relations with the West, and have not made a determined effort to reinsulate the East European states from Western influence. While drawing the line on Poland, then, the Soviets still appear to be willing to tolerate Western policies of differentiation so long as the basis for Soviet control is not directly threatened.

Economic Impact on the Soviets: Western economic cooperation with Eastern Europe under the policy of differentiation has relieved the USSR of some of the burden of supporting its Allies' economies. This must be weighed, however, against the political and economic benefits which have accrued to the West as a result: reduced Soviet control and leverage over political and economic decision-making in the East European states; and expanded Western trade relations with the East Europeans, with the corollary benefits for industrial production, employment in Western Europe and, especially in the U.S. case, commercial exports of agricultural products. Moreover the levels of Western trade have not historically been so high as to have constituted a significant indirect subsidy to the Soviet military sector, in the context of a Soviet defense budget which, in dollar terms, is approaching \$200 billion per year. However, the qualitative effect of indirect transfers of unique technology and specialized equipment needed for modernization of Soviet economic and military capabilities has been important.

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Expanded trade relations with the East European states have, on a few occasions, had the unintended side-effect of providing the Soviets with indirect access to some advanced Western technologies, whose export to the USSR is prohibited under national and COCOM guidelines. Such instances, however, were the consequence of faulty implementation of the policy of differentiation rather than of the policy itself.

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The policy of differentiation together with developments in the region, have had an adverse impact on Moscow's ability to utilize the Warsaw Pact for its own ends. In particular, the greater freedom of action in internal and external policy and the increased emphasis on nationalism which differentiation has helped foster has had an impact in five key areas.

Pact Military Budgets. Moscow has pushed hard for increases in non-Soviet Warsaw Pact (NSWP) spending since NATO's 1978 decision to modernize its military forces. Only one country, however, the GDR, appears to have significantly increased its military budget in the last four years. The others, have either flat out refused to increased military spending (Romania) or have dragged their feet (most notably Hungary and Poland). As a result, in terms of equipment, NSWP forces fall considerably below the levels desired by Moscow's military planners.

Pact Military Integration. The public Romanian refusal in 1978 to integrate its forces more closely within the Pact, has hampered Moscow's efforts to gain tighter control over NSWP forces. While NSWP forces in the Northern Tier region (the GDR, Czechoslovakia, and Poland) appear to be more closely tied to the Soviets than those in the Southern Tier (Hungary, Romania, Bulgaria), their degree of integration still leaves much to be desired from the Soviet standpoint. For example, the Polish armed forces operate independently to a significant degree.

Exercises. Romania's refusal to participate in many Pact exercises, and its tendency to send token contributions to others, seriously hampers Moscow's ability to operationalize the Pact's doctrine of "coalition warfare." It should be noted, however, that despite the Romanian problem, a large number of highly integrated exercises do occur among Northern Tier countries and the U.S.S.R.

Reliability. The emphasis on national independence, which is fostered by a policy of differentiation serves to reinforce the strong anti-Soviet feelings of the vast majority of East Europeans. At the same time, our efforts to build close ties with this area intensify the region's pro-Western orientation. Taken together, these two factors severely undercut the willingness of NSWP forces--especially conscripts--to fight

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with vigor if they perceive the conflict to be primarily in Moscow's interest. As a result, the reliability of these forces in a NATO-Warsaw Pact conflict becomes more problematical.

Political Support. While the Romanians have taken the lead in opposing Moscow on a number of its favored policy positions within the Pact, other NSWP countries have also at least passively opposed the Soviets in some instances. As a result, the Soviets have found it necessary to modify some of their positions in key areas (e.g., China, Afghanistan) in order to gain the Pact's imprimatur for certain foreign policy statements/proposals.

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The Allies tend to consider the Eastern European countries as estranged members of the same family. Traditionally, they have tried to avoid retrogression in East-West relations and a monolithic approach to Eastern Europe because they have feared this might contribute to a tightening of Soviet controls over Eastern Europe and increase tensions in Europe. There were infrequent occasions, such as after the Soviet intervention in Hungary in 1956 and Czechoslovakia in 1968, when differentiation temporarily gave way to a more monolithic approach. However, this state of affairs did not last long. The Allies quickly revived their economic and cultural ties with Eastern Europe and sought to restore their political influence in the East-West balance.

Allied Differentiation. Since World War II our European Allies generally have practiced a policy of differentiation toward the various countries in Eastern Europe. Today they strongly favor such a policy. Historically, those Allies closest to Eastern Europe, the FRG in particular, have taken the lead in differentiating among their Eastern neighbors. Germany's Ostpolitik and specific relationship with the GDR have been the most visible example of differentiation, but others, including France and Italy, have also sought to avoid lumping all Eastern European countries together with the Soviet Union into an undifferentiated whole.

Harmel Report. Formal Allied commitment to the improvement of relations with the East began with the Harmel Report. This document, which was approved by the NATO Foreign Ministers in December 1967, focused on the continuing relevance of the twin political and military functions of the Alliance: to assure defense and to pursue dialogue. It set forth the idea that "the ultimate political purpose of the Alliance is to achieve a just and lasting peaceful order in Europe accompanied by appropriate security guarantees." The importance lent to dialogue presupposes - or has as its logical corollary - the development of relations with Eastern European countries on a case-by-case basis and on the merits of each of them.

East-West Cooperation. The establishment of relations between the FRG and the GDR in 1972 and the implementation of the Quadripartite Agreement on Berlin in the same year provided practical examples of East-West cooperation and gave further impetus to differentiation. Discussions leading to the

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Conference on Security and Cooperation in Europe in 1975 stimulated increased bilateral relations between individual Allies and the Eastern European states.

Ties in the 1970s. Indeed, relations with both much of Eastern Europe and the USSR increased and broadened during the 1970s as the pattern of political and economic interaction between East and West became more intensive and varied. Political dialogue and the development of economic cooperation, together with modest progress in human contacts, constituted an important element in West European relations with individual Eastern European countries. Intensified contractual cooperation between the two German states played an essential part in attempts to abate political confrontation at the dividing line between East and West in Europe.

European Economic Relationships. Our European Allies have economic relations with Eastern Europe and the Soviet Union which are moderately important in the present world economic situation. In 1980, imports of European NATO countries from European CEMA states were 4.3 percent of their total imports. European NATO countries sold to these countries 4.0 percent of their exports in the same year. Nearly half this trade, in each direction, was with the Soviet Union. Still, the absolute amounts of Allied trade with Eastern Europe are significant. More important, East/West trade is concentrated in relatively few commodities unlike West/West trade. In a few West European industrial sectors, this commerce has an importance commensurate with the impact on the U.S. agricultural sector of Soviet grain purchases. For the FRG, the GDR is also, partly for political reasons, a major trade partner, absorbing 3.2 billion dollars of FRG exports in 1980.

European Economic Relationships. France and Italy were the second and third largest traders with European CEMA countries in 1980 after the FRG. The UK and the U.S. reflected a lower level of trade ties in fourth and fifth place respectively. These trade patterns between Eastern and Western Europe have been relatively stable in recent years.

NATO Policy. In May 1978, the NATO Foreign Ministers confirmed the validity of the Harmel Report and concluded that, while maintaining a credible level of deterrence and defense, there was no acceptable alternative to the pursuit of meaningful relations with the East. The Allies agreed that strengthening

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bilateral relations, particularly in the economic, cultural and social fields, with the Eastern European countries, could contribute to the objective of securing cooperation rather than confrontation in Europe. Logically, such a policy could only be implemented vis-a-vis Eastern Europe in a differentiated manner. For example, clearly the FRG will not have the same set of relationships with Romania that it has with the GDR.

Allied Views on U.S. Policy. U.S. continued adherence to a policy of differentiation in Eastern Europe likely would be welcomed by the Allies and would be a positive factor in the relationship between the U.S. and its NATO partners. The European Allies have vital interests of their own to protect and promote - - especially in the economic sphere - - in Eastern Europe. They would likely offer strong resistance to attempts to treat Eastern Europe as an undifferentiated whole.

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SECRET/SENSITIVED. EAST-WEST ECONOMIC RELATIONSIntroduction

This paper addresses only the economic aspects of the policy of differentiation as it relates to East-West economic relations and thus is only a partial assessment. The benefits and costs of a policy of differentiation, however, cannot be judged solely in economic terms. The economic gains or losses of extending or withholding MFN, credits, and other advantages were always considered to be modest and of secondary importance to our political objectives.

Background and History

The history of U.S. commercial and financial policy towards Eastern Europe reflects a certain tension between two goals: (1) encouraging the development of more liberal political, economic and social trends within these countries and fostering their adoption of foreign policies independent of the USSR; and (2) denying preferential treatment and assistance to countries considered to pose a threat to U.S. security interests. In seeking to achieve these objectives, U.S. policy has differentiated in favor of Hungary, Poland, and Romania but has maintained a restrictive stance towards the USSR, Bulgaria, Czechoslovakia, and the GDR. The economic policy tools used to implement differentiation between the treatment accorded the USSR and Eastern European countries and among the latter include: extension of Most Favored Nation (MFN) tariff treatment (by law based on reciprocity in tariff concessions and mutual benefit and assurances on emigration); extension of Export-Import Bank and Commodity Credit Corporation (CCC) credits guarantees (terms on some such credits may be more favorable than market rates, and government lending may facilitate private bank lending by raising confidence); concessional sales of foodstuffs (Poland has received the great preponderance of such assistance); and modestly less restrictive application of export controls for some countries in comparison with treatment accorded the USSR. In general, Poland has benefited the most and over the longest period from this differentiated approach. It gained MFN treatment in 1960 and has enjoyed considerably more benefits from U.S. credits than Hungary and Romania.

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In the early 1970's the impetus for improving economic relations with Eastern Europe was associated to a large extent with detente and expanded ties with the USSR, rather than with differentiation per se, although differentiation was in fact practiced, giving Poland and Romania more favorable treatment than either the USSR or other Eastern European nations. In 1972, the US-USSR Trade Agreement promised MFN treatment and other economic benefits for Moscow and the Soviets gained access to Export-Import Bank credits. The Jackson-Vanik Amendment to the Trade Act of 1974, however, defined the limit of U.S. policy by making MFN and official credits for communist countries (except Poland and Yugoslavia) contingent on the individual country's performance in ensuring free emigration. The USSR has failed to meet the Jackson-Vanik criteria and thus did not obtain MFN and, since 1974, was denied EXIM credits.

Romania in 1975 and Hungary in 1978 were certified as eligible for MFN and official credits, and they have cleared the subsequent annual reviews. East Germany, Czechoslovakia, and Bulgaria have not yet begun the process. In the mid-1970's Poland drew heavily on both EXIM and CCC credits, and \$670 million in CCC credit guarantees were crucial to Poland during 1980-81 when commercial credits were not otherwise available to finance Warsaw's huge grain imports. Romania also has used EXIM and CCC credits, while Hungary, a food exporter, has drawn only a very small amount of CCC credits. With the exception of Poland, the preponderance of U.S. lending to Eastern Europe has been by private commercial banks. Export control policy has also differentiated among bloc countries, if slightly. COCOM, the multilateral Western export control body, adopted a procedure in 1957 permitting special consideration on exception cases to Poland, but in recent years there has been no effective differential applied to exports to that country. Since 1980 the COCOM members have applied with a few exceptions a no-exceptions policy on the USSR. This policy has now been extended to Poland. Largely because of U.S. licensing policies differentiation on COCOM cases for Hungary has been only cosmetically more favorable and only marginally more liberal for Romania. Under unilateral export controls Romania and Hungary are still in a separate country group for licensing purposes, implying more favorable consideration.

Costs and Benefits

In embarking on a policy based on differentiation, the United States sought to improve relations with the countries of Eastern Europe on a broad range of issues as well as to reap possible economic gains from increased trade. U.S. businessmen

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envisioned untapped markets in CEMA for grain, capital goods and technology, and even consumer goods. Bankers were willing to lend to facilitate the trade and to cover the East's temporary inability to export enough to pay for the imports. Western imports were expected to strengthen the Eastern economies and increase their export potential.

As result of the improved climate for trade, U.S. trade with Eastern Europe climbed dramatically from a very low base. U.S. exports to the area increased 250 percent between 1972 and 1975, and imports rose 191 percent. Poland, Hungary, and Romania -- favored by U.S. policy -- recorded much faster growth than did the other three, even before the liberalization of economic relations. Although the trade flows have always been too small to have more than a negligible impact on our economy, manufacturers of capital equipment and farmers welcomed the sales to the East, and the cost to the U.S. government was small and confined largely to direct CCC credits at subsidized interest rates. On economic grounds, the benefits of detente and differentiation in the first half of the 1970s did outweigh the costs since the latter were small.

Beginning in the mid-1970s, the onset of debt and absorption problems in Eastern Europe began to reduce the rate of growth of their trade with the West. The flows of Western capital goods to the East proved ineffective in producing the needed increase in East European exports. The result was a further increase in debt and debt service. Trends in U.S. trade with Eastern Europe were similarly affected, with the exception of a continued boom in sales of agricultural products as a result of several disappointing crops in Eastern Europe. U.S. trade with Romania and Hungary, for example, increased for a short period after they gained MFN and access to Export-Import Bank credits.

-- U.S. trade with Romania rose sharply between 1975 and 1980, but stagnated last year as a result of payments problems.

-- U.S. trade with Hungary recorded a modest increase after Budapest was granted trade benefits in 1978, but also slowed in recent years. Regardless of U.S. policy, until the East European countries are able to improve their export performance and deal effectively with their debt servicing problems, the West will not enjoy the gains from trade anticipated in the early 1970s although some of the Eastern European countries remain significant markets for agricultural exports, notably grain, even at present levels of trade.

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In the past year, the costs to the U.S. of our past lending policies to Poland have escalated as it has been unable to service its debts. The United States has rescheduled Warsaw's direct official loans and assumed the debts to U.S. banks that carry a government guarantee. The revenues foregone and payments made in 1981 totaled \$381 million; the comparable figure for 1982 could be about \$640 million. Because the prospects for repayment of loans originally extended and recently assumed are questionable, the ultimate costs could be much higher. Romania also has approached the Paris Club for a rescheduling of official debt, but the United States has not yet agreed to reschedule. Romania's debt to the United States is not as large as that of Poland, and the cost to the government would be correspondingly smaller.

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SECRET/SENSITIVEE. INTRA-WARSAW PACT AND INTRA-CEMA RELATIONS

The Polish crisis has sorely tested Moscow's willingness to accept "national peculiarities" among its Warsaw Pact allies as the price for their political stability and economic viability. Earlier crises, resulting in the Soviet invasions of Hungary in 1956 and Czechoslovakia in 1968, had given form to a so-called "Brezhnev Doctrine" by which the Soviets reserved the right to intervene militarily "to defend socialism". Imposition of martial law in Poland marked for the first time their willingness to accept undisguised military rule in a communist country for the same purpose.

Yet despite the facade of Pact cohesion, Moscow has often been unable to achieve a consensus among its allies on key issues or in times of stress, e.g., foot dragging on military integration, opposition to increased defense spending, and reluctant support on Afghanistan and Poland. Their individual stances on these and other issues had reflected persistent efforts to preserve national identities and pursue individual national interests.

Most of Moscow's allies nevertheless welcomed martial law as arresting Poland's potential drift from the Warsaw Pact and CEMA. Still, most did not issue formal party and government statements endorsing it. Uncertainty over duration of military rule and the eclipse of the Polish communist party were of serious concern to them, as well as to Moscow. But most were also concerned over the implications of martial law for detente, especially its impact on the CSCE process.

Generally, the East European countries have supported the CSCE process because they perceived it as a way to expand their political, economic and trade relationships with the West without causing undue anxieties in Moscow. US sanctions against the USSR and Poland, as well as possible West European retaliation, threaten these prospects. Trade patterns within CEMA had already altered substantially in recent years; only Bulgaria's overall trade remains overwhelmingly (72%) within the Council framework. For Romania and Poland, CEMA trade in 1980 comprised only 39% and 56% respectively, Hungary noticeably reduced its CEMA trade level as well, to 62%. This pattern of redirection has been primarily to the advantage of the West.

The Polish crisis has also strained relations within the Warsaw Pact. Since its onset, Moscow has evidently been able to convoke only one multilateral Pact gathering specifically on

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Poland -- an extraordinary "Summit" of party chiefs in Moscow in December 1980. The party chiefs affirmed then that Poland would remain a socialist state, but, apparently because of Ceausescu's presence (he boycotted the 1968 pre-invasion Pact sessions on Czechoslovakia), there was no consensus for immediate military action.

Consensus on Poland apparently eluded Moscow at the meetings of the Pact's foreign ministers' committee (October 1980 and December 1981) as well. In any event, the communiqués failed to mention Poland. Furthermore, the latter session reportedly was delayed because of Romania's determination to avoid any appearances of concerted, overt pressure on Poland. Romania, which limits participation in Pact military activities, has toned down its anti-Pact demeanor in the last two years, but Ceausescu's policy of differentiating Romania from the Pact (e.g., on the Middle East, Afghanistan, Kampuchea, and disarmament issues) remains largely intact. (Bucharest has not, however, formally followed up on its earlier requests for U.S. military assistance.)

Romania, and to a lesser extent Hungary, also appeared to disassociate themselves from their Pact allies in the polemics over Poland during the recent CSCE session in Madrid. Hungary is the only Pact state to notify small scale maneuvers under the CSCE notification regimes; Moscow and most other Pact countries comply only on a strictly minimal basis.

Moscow also tried with little success, apparently, to use the Council for Mutual Economic Assistance (CEMA) to coordinate policy on Poland. But the crisis seems to have disrupted CEMA's annual summit in 1981; among other things, there was no agreement on ways to provide economic assistance to Warsaw and some grumbled over Poland's failure to meet delivery schedules. Evidently, the differing interests and perspectives of the CEMA members precluded any workable consensus. CEMA's Executive Committee in Moscow in January 1982 did pledge "all-around assistance" for Poland, but again the results to date appear to be minimal. The committee was, however, able to agree on criticizing sanctions by the US and other NATO countries as "crude violations" of the Helsinki Act and the UN Charter.

Soviet economic assistance to Poland in 1982 encompassed ruble credits to cover a projected 1.2 billion ruble trade deficit (approximately \$1.7 billion) and additional deliveries of goods (worth up to \$100 million) which Poland normally purchases in the West. The Poles assert that other CEMA partners have provided an additional 50 million rubles (equivalent to about

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\$70 million) in grants or, more likely, above-plan deliveries, mainly of consumer goods. Jaruzelski's Moscow visit in March 1982, his subsequent follow-up trips to the GDR and Czechoslovakia and to Hungary and Bulgaria -- after three months of relative isolation from Pact contacts -- reflect the Polish regime's determination to obtain whatever political and economic support it can get from its allies.

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A number of factors have influenced the perceptions of U.S. banks and corporations about Eastern Europe. Profitability has been a major criterion in their decisions to enter a certain East European market. U.S. companies and banks also have responded to the improvement in the economic and business atmosphere resulting from application of different USG instruments of differentiation.

Banks. Most U.S. banks decided to enter the Soviet and Eastern European market in the early 1970's on the basis of senior bank managements' perceptions that East-West detente and improved U.S.-Soviet relations had greatly reduced the political risk of East-bloc lending. These impressions were reinforced by the profitability banks experienced in lending to the East during most of the period. Subsequently, bank loan officers aggressively expanded credit to the region, building up the highest exposures in countries where U.S. and Western trade -- and hence demand for credit -- was greatest. By the end of 1981, U.S. banks had their greatest exposure in Poland, Hungary, and the GDR. While assessments for commercial risks among East European borrowers varied, there is no evidence that banks pursued a conscious policy of differentiating between these countries on political risk factors alone.

Since the late 1970's, U.S. banks have reappraised their earlier commitment to East bloc lending. In response to rising U.S.-Soviet tensions over Afghanistan and Poland, and growing criticism from bank stockholders, directors, and the media, American banks have sharply scaled back, and in some cases terminated, credit lines for Soviet and East European borrowers, including Yugoslavia, not a member of the Warsaw Pact. According to information provided by U.S. bankers, the high-level decisions to curtail or withdraw credits have been applied across-the-board, with little or no differentiation between the USSR and Eastern Europe or among individual East European countries. Senior banking officials, in contrast to bank loan officers, are less likely to be familiar with the nuances of East-West affairs and are more readily influenced by adverse political developments and attendant publicity than arguments about the distinctiveness of individual Eastern European countries.

Corporations. Improvement in the business atmosphere resulting from U.S. differentiation policy has affected corporations' assessment of the profitability of doing business in Eastern Europe. Key elements of USG differentiation have been MFN tariff treatment; government-supported credits; and joint trade commissions with Hungary, Poland and Romania.

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Application of these elements of differentiation has aided in fostering a network of business relationships between U.S. companies and Eastern European enterprises. Total U.S. exports to the six Eastern European countries have grown from \$240 million in 1970 to over \$2 billion in 1981. Although exports to Eastern Europe comprise less than one percent of total U.S. exports, Eastern Europe has been a particularly important market for U.S. agricultural and chemical exports.

Generally, U.S. business presence is more visible in Poland, Romania, and Hungary than it is in the other three Eastern European countries. Poland's well known economic and financial problems have halted development of private business relationships. But there has been no general move by U.S. business interests in Poland to close or curtail their operations. As an indication of this:

- Total trade turnover between the U.S. and Poland, Romania, and Hungary reached \$2.3 billion in 1981, compared to \$785 million total bilateral trade with Czechoslovakia, Bulgaria and the GDR;
- The number of U.S. companies engaged in industrial cooperation arrangements with Polish, Romanian and Hungarian enterprises exceeds 100 (including nine joint ventures), compared to an estimated 20 with enterprises from the GDR, Bulgaria and Czechoslovakia, with which there are no joint ventures.
- The number of U.S. company representation offices in Poland, Romania and Hungary is 55. This compares to around 11 offices in the other three Eastern European countries.
- U.S. company involvement in major projects in Poland, Romania and Hungary generally has been more extensive than in the other three countries. The availability of USG financing for major projects has been one factor behind this involvement.
- Private sector cooperation and government agricultural cooperation activities generally are more strongly developed in Hungary, Poland and Romania than in the other countries.

In part, U.S. company physical presence in Eastern Europe has been a function of the regulations in the individual countries governing joint ventures, industrial cooperation, and Western company representation. It also reflects U.S. company response to business operating conditions and the bilateral business atmosphere in a particular country. Generally, U.S. firms have developed more extensive commercial ties in those countries which the USG has treated more favorably in its differentiation policy.

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AppendixWestern Banks' Lending to Eastern Europe

The following table sets forth lending flows to individual Eastern European countries since the end of 1977 from banks in the BIS (Bank for International Settlements) reporting area. This lending has accounted for roughly five percent of total international lending by these banks. The bulk of the credit during this time span has gone to Poland, the GDR and Romania, with lending to Romania having grown the most rapidly in relative terms. Loans to the USSR grew relatively slowly through 1980 but accelerated in 1981.

There are two significant limitations to the data:

- 1) The claims reported by banks include those which are guaranteed by Western governments, largely under export credit programs. (It is possible to separate guaranteed claims for U.S. and U.K banks, but that is not done here.)
- 2) Exchange rate fluctuations distort the data because non-dollar claims are translated into dollar equivalents at current exchange rates; this means that the actual increase in claims is understated during a period in which the dollar appreciates. The estimated increase in claims on all of Eastern Europe after taking this factor into account is as follows:

1978:	\$8.4 billion
1979:	\$5.1 billion
1980:	\$7.7 billion
Jan-Sep 1981:	\$3.5 billion

In addition, Germany does not report claims of banks vis-a-vis the GDR.

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AppendixBank Claims on Eastern European Countries
\$ billions

	<u>Increase</u>			<u>Jan-Sep</u> <u>1981</u>	<u>Position</u> <u>Sep 30, 1981</u>
	<u>1979</u>	<u>1979</u>	<u>1980</u>		
Albania	-	-	-	-	0.1
Bulgaria	0.5	-0.1	-0.5	-0.6	2.1
Czechoslovakia	0.5	1.0	0.5	-0.3	3.2
German Dem.Rep.	1.3	1.8	1.4	0.6	9.8
Hungary	1.7	1.1	0.1	-0.7	6.9
Poland	2.6	3.4	0.3	-1.4	14.2
Romania	1.1	1.5	1.4	-0.8	4.7
USSR	<u>1.1</u>	<u>-</u>	<u>0.4</u>	<u>2.3</u>	<u>15.4</u>
Total	9.2*	8.6	3.6	-0.6*	58.7*

*While the primary source is a series which covers all lending, in some cases it was necessary to use a series with less complete coverage, mainly reflecting non-reporting of claims of banks in Switzerland. The difference between the sum of the figures for individual countries and the total figure represents an unallocated residual.

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IV. INSTRUMENTS FOR IMPLEMENTING DIFFERENTIATION

A. MFN AS AN INSTRUMENT OF DIFFERENTIATION

Current Status

At present, three Warsaw Pact members in Eastern Europe (Poland, Romania, and Hungary) receive non-discriminatory tariff treatment (Most-Favored-Nation tariff treatment--MFN). Both Romania and Hungary, whose MFN waiver requires annual renewal under Section 402 of the Trade Act of 1974, have expressed interest in receiving either permanent or at least multi-year MFN. Bulgaria, Czechoslovakia and the GDR do not now receive MFN. All three countries have expressed interest in receiving MFN and consider its denial discriminatory and a major barrier to improved relations.

Effectiveness of MFN as an Instrument of Differentiation: MFN was withdrawn from Poland, Romania, Hungary, Czechoslovakia, and Bulgaria in 1951. Since non-discriminatory tariff treatment was restored to Poland in 1960, MFN has become a very visible step in improvement of U.S. relations with a communist country and a symbol of our differentiation among them.

MFN was extended to certain East European countries in recognition of domestic and/or foreign policies we regarded as positive and sought to encourage further. In the case of Poland in the early 1960's, we sought to respond to the first instance of a Warsaw Pact country adopting internal reforms, allowing certain freedom of action to institutions such as the Catholic Church, and actively attempting to improve its bilateral relations with us over a broad spectrum of issues. MFN was extended to Romania largely as a gesture of support for Romanian efforts to develop a foreign policy line independent from that of its Warsaw Pact neighbors. The granting of MFN to Hungary came towards the conclusion of an extended normalization process in our bilateral relations. This process was fostered by the strong Hungarian interest in expanding economic relations with the West, its continued pursuit of the most extensive program of market socialism and economic decentralization in the Warsaw Pact, and Budapest's relatively enlightened approach to dissidents, travel and emigration.

Politically, our failure to extend MFN has been viewed by the East European countries as a blatantly discriminatory action, particularly by those countries which have not been made eligible. This is especially so since the U.S. extends MFN to well over 100 of its trading partners, with the communist countries being the only major group to which we deny this treatment. Furthermore, the United States is the only

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developed (OECD) country that does not extend MFN treatment to the East European countries. In normal international commerce, MFN is not a special privilege, but a reciprocal and minimal treatment one accords all one's trading partners within the GATT framework.

For the East European countries, non-discriminatory tariff treatment is also an economic issue with long range importance. Since U.S. non-MFN tariff rates are far higher than MFN rates for almost all manufactured products, the absence of MFN renders a wide variety of East European products non-competitive in the U.S. market, and, at best, sharply reduces profit possibilities. Given the greater share of manufactured goods in their exports to the West, MFN has proportionately greater economic importance for the East European countries than it does for the USSR. The extension or denial of MFN, therefore, is a significant form of leverage in a differentiation context.

Recent analyses by the Commerce Department of the prospects for trade with each of the East European countries estimated that each country's exports to the U.S. in 1985 would be \$25 million to \$35 million higher with MFN than without MFN (Table 1). Although MFN is not the sole determinant of export prospects, the large difference between the export levels of MFN and non-MFN East European countries (\$1 billion vs. \$149 million in 1981), especially for manufactured goods (\$585 million vs. \$121 million in 1979), is striking (Tables 2 and 3). Although the rate and speed of growth varied, Polish, Romanian and Hungarian exports to the U.S. all grew following the extension of MFN (Table 4).

These figures suggest that the East European countries stand to gain economically from reduced average tariffs on exports to the U.S., but that these gains are likely to be gradual and modest. Western Europe remains the key market for East European manufactures, even for a country such as Poland which has long enjoyed MFN with the U.S.

The benefits of multi-year MFN are even more difficult to estimate. The principal benefit of multi-year MFN most often cited by both East European and American companies is the greater confidence and security it would provide for long-term co-production and joint venture arrangements.

For the United States, the economic benefits to be gained from MFN are less important than they are for the East Europeans, but still not insignificant. U.S. exports to the countries having MFN have grown more rapidly and are significantly larger than exports to non-MFN countries (\$1.3 billion vs. \$636

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million in 1981). (Table 5) This is especially true for manufactured goods (\$260 million vs \$65 million in 1979). (Table 6) Failure to grant MFN can produce pressure for retaliation against U.S. products, such as in Czechoslovakia, which has just introduced a special high duty for American products. Trade Ministries may instruct enterprises and foreign trade organization to view the U.S. as a supplier of last resort.

Although recent Commerce analyses suggest that an MFN relationship would have a positive effect on sales to these countries (Table 7), Eastern Europe will continue to be a small market for U.S. exports (about one percent). This is not true for grains, however, in which Eastern Europe take 13 percent of U.S. exports.

MFN relationships undoubtedly make it somewhat easier for U.S. exporters to do business in these countries. The business facilitation, trade promotion, patent protection, disputes settlement, and information sharing provisions of the trade agreements improve conditions for U.S. companies. Of value to us also are the contacts established between institutions and people in the course of commercial contacts.

Effectiveness Summarized: In addition to the economic benefits it holds out for the East European countries, MFN has come to represent the culmination of a process of normalization in our bilateral relations. These factors make MFN a significant instrument of differentiation in dealing with countries of Eastern Europe. We should not overestimate, however, how much we can obtain from Eastern European governments. While MFN may serve as a "reward" for either domestic or external behavior which we approve or encourage, MFN is not a very large "carrot" by which to bring about a major change in a country's basic orientation. Countries will not change their basic foreign or domestic policies for the sake of MFN. At the same time experience suggests that MFN can be used to advance other important objectives, such as resolution of U.S. claims, better media treatment of the U.S., or improved emigration and human rights performance.

We should make it clear in discussing possible future MFN agreements, that we will not accept the separation of MFN and our commercial relations as a whole from the other aspects of our bilateral relationship. For our part, the conclusion of an MFN agreement is symbolic of our desire to have productive, positive relations across the board. Such a relationship presupposes that governments will demonstrate responsiveness to U.S. concerns on issues such as family reunification, human rights and extremely negative treatment of us and our policies in the domestic media.

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Constraints on MFN as an Instrument of Differentiation
Sec. 402 (Jackson-Vanik Amendment) of the Trade Act of 1974:
 The Jackson-Vanik Amendment constrains our use of MFN as an instrument of differentiation in three ways:

(a) Section 402 does not differentiate among communist countries. The Soviet Union, China and the East European countries (with the exception of Poland, which is not covered by Jackson-Vanik) are all treated in the same way regardless of their individual political, economic, or emigration policies. The fact that the basic legal authority for extension of MFN does not differentiate complicates U.S. efforts to use MFN as an instrument of differentiation.

(b) Section 402 constrains the Executive in setting conditions for MFN. Under this section, the emigration policy of a country is a preeminent legal condition for extending MFN. The Executive may set additional conditions for extension of MFN to a given country, but it legally cannot extend MFN even if all these conditions are met unless the President has received assurances that the emigration practices of the recipient country will lead substantially to the achievement of free emigration.

(c) Section 402 limits the period for which MFN can be extended under the waiver procedure to one year only and the attendant trade agreement to a three-year term.

Differentiation Through MFN: At present we differentiate by extending MFN to three Warsaw Pact members in Eastern Europe and not to the other three or the Soviet Union. Greater differentiation through MFN could be accomplished along two lines.

I: Differentiation between Eastern Europe and the USSR could be advanced by making a policy decision to work toward the extension of MFN to Bulgaria, Czechoslovakia and the GDR. This would result eventually in the extension of MFN to all the Eastern European countries, but not the USSR. This could be accomplished without changing present legislation provided governments were willing to provide us with assurances on emigration.

In those cases in which Eastern European countries meet the criteria of U.S. law for the extension of MFN, the extension of MFN on an annual basis serves as a tool of leverage for

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promoting our emigration and human rights objectives. Should it be determined that these objectives would be advanced further through the extension of multi-year MFN, the possibility of an attempt to amend the law should be considered.

Giving the President greater discretion in using MFN as an instrument of differentiation would require amending legislation loosening the link between MFN and emigration and introducing broader national interest considerations. It is doubtful whether the benefits would be commensurate with the difficulties and possible domestic costs of seeking such an amendment since there would be broad opposition publically, and in the Congress as well as within the Administration.

Action Required

Identification and satisfactory achievement of the political and economic conditions we would expect each country to satisfy for proceeding with MFN (e.g., GDR settlement of claims; more positive Czechoslovak and Bulgarian media treatment of U.S.; Czech progress on emigration, family unification and the treatment of dissidents as well as its media portrayal of the U.S.). (At least one country, Bulgaria, has indicated it will be seeking clarification of our conditions, other than Jackson-Vanik, for progress toward MFN, the implication being that the development of emigration assurances might proceed forward if other conditions proved acceptable.)

II. In addition to the present policy of withholding MFN from countries not meeting our condition, differentiation among the Eastern European countries could be increased by extension of multi-year or permanent MFN to the most favored East European countries.

Required Action:

Amendment of Trade Act of 1974.

III. Proceeding simultaneously along both line I and II would permit maximum differential use of MFN.

RECOMMENDATION

The following is suggested as the recommendation on MFN emanating from NSSD 5-82.

"It will be U.S. policy to extend MFN to the countries of Eastern Europe not currently receiving it only when

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they meet our criteria for eligibility. Our actions in this regard will depend on the readiness of each East European government to settle outstanding issues and enter into a constructive bilateral relationship with us. Such a relationship presupposes that an East European government will be responsive to our concerns on issues such as family reunification, human rights, (including emigration).

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Table 1. ESTIMATED EAST EUROPEAN EXPORTS TO U.S. 1985
(millions of dollars)

<u>Country</u>	<u>1981 Actual</u>	<u>1985 Without MFN</u>	<u>1985 With MFN</u>
Bulgaria	34	52	86
Czechoslovakia	67	70	108
GDR	48	80	105

Source: U.S. Dept. of Commerce Staff Papers

Table 2. 1981 EXPORTS OF EAST EUROPEAN COUNTRIES TO U.S.
(millions of dollars)

<u>Countries Receiving MFN</u>		<u>Countries Not Receiving MFN</u>	
Hungary	128	Bulgaria	34
Poland	365	Czechoslovakia	67
Romania	560	GDR	48
TOTAL	1053		149

Table 3. U.S. SHARE OF IW MANUFACTURED IMPORTS FROM
EASTERN EUROPE - 1979
(value in millions of dollars; share as percentage)

<u>Countries Receiving MFN</u>			<u>Countries Not Receiving MFN</u>		
	<u>\$ Million</u>	<u>Share</u>		<u>\$ Million</u>	<u>Share</u>
Hungary	82	5.9	Bulgaria	7	2.3
Poland	251	11.2	Czechoslovakia	83	2.6
Romania	252	16.6	GDR	31	1.2

Source: U.S. Dept. of Commerce Trade Trends

Table 4. GROWTH OF EAST EUROPE EXPORT TO U.S. FOLLOWING
EXTENSION OF MFN (millions of dollars)

<u>Country</u>	<u>Date of MFN</u>	<u>Year</u>	<u>Exports to U.S.</u>
Poland	Dec. 1960	1960	39
		1961	41
		1962	46
		1963	43
		1966	66
		1968	97
		1971	107
		1975	259
		1979	426

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Romania	July 1975	1975	155
		1976	199
		1977	233
		1978	347
		1979	329
		1980	312
		1981	560
Hungary	July 1978	1978	68
		1979	112
		1980	107
		1981	128

Table 5 1981 U.S. EXPORTS TO EAST EUROPEAN COUNTRIES
(millions of dollars)

<u>Countries Receiving MFN</u>		<u>Countries Not Receiving MFN</u>	
Hungary	78	Bulgaria	258
Poland	681	Czechoslovakia	82
Romania	<u>503</u>	DGR	<u>296</u>
TOTAL	1262	TOTAL	<u>636</u>

Table 6 U.S. SHARE OF IW MANUFACTURED EXPORTS TO
 EASTERN EUROPE - 1979
(value in millions of dollars; share as percentage)

<u>Countries Receiving MFN</u>			<u>Countries Not Receiving MFN</u>		
	<u>\$ Million</u>	<u>Share</u>		<u>\$Million</u>	<u>Share</u>
Hungary	53	2.5	Bulgaria	11	1.2
Poland	105	2.6	Czechoslovakia	31	1.6
Romania	102	3.8	DGR	23	0.7

NOTE: IW-Industrialized West, which includes the EC plus Austria, Canada, Finland, Japan, Norway, Sweden, Switzerland, and U.S.

Table 7 ESTIMATED U.S. EXPORTS TO EAST EUROPE - 1985
(millions of dollars)

<u>Country</u>	<u>1981 Actual</u>	<u>1985 Without MFN</u>	<u>1985 With MFN</u>
Bulgaria	258	260	330
Czechoslovakia	82	215	301
GDR	296	620	730

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B. CREDITS

U. S. and Western lending to CEMA countries expanded rapidly from a low base in the 1980's as part of a general expansion in international lending and the policy of detente. In many ways this was a natural development for the Eastern European countries which were eager to industrialize, wean their economies from total dependence on the Soviet Union, and overcome the economic stagnation such dependence implied.

All the Eastern European countries depend on the West for an important share of their trade, and all have accumulated hard currency indebtedness to the West as a result of trade which must be serviced. Eastern Europe is thus absolutely dependent on continued access to international financial markets; either denial or substantial curtailment of Western credit to Eastern Europe would cause serious economic dislocation and policy difficulties with attendant political implications for governments in the region.

Differentiation is thus a key factor in determination of our credit policy toward Eastern Europe. No Eastern European country is free to follow an independent course of economic development without access to Western credits. The alternative is lower productivity and slower economic growth as a result of more autarchic economic policies and greater economic dependence on the Soviet Union. Moreover, experience has demonstrated that such economic dependence reinforces Soviet political leverage.

U.S. experience with the policy of differentiation, including relatively free access by Eastern European countries to Western capital markets as well as the extension of U.S. direct credits and credit guarantees (EXIM and CCC primarily), has produced mixed economic results but substantial political and foreign policy benefits. Western official and private bank credits, more than any other factor, are responsible for enabling the leadership of Eastern European countries to raise living standards and adopt more flexible market-oriented economic policies and management techniques as an alternative to rigid Soviet-style economic centralism. Hungary is the best example of evolution toward Western economic structures. In Poland, however, economic structures were not adapted to the new

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technologies being purchased from the West. The result has been a gross misallocation of investment resources, overdependence on Western food and industrial imports and a hard currency debt accumulation which Poland could not now service even with the debt rescheduling and continued flows of new credits from the West. Poland, as a major debtor, now enjoys a reverse leverage over the West. Romania, with debt servicing problems of its own, presents the West with a similar, though far more manageable, problem.

Eastern European debt problems notwithstanding, a consistently applied policy of differentiation in credit policies toward Eastern Europe can still maximize our economic leverage on governments in the regions, provided greater attention is paid to the borrowing country's economic policies and overall creditworthiness. The large European role in lending to Eastern Europe limits the effectiveness of a unilateral credits policy. Consequently, allied cooperation should be sought for a differentiated credit policy toward Eastern Europe.

A more prudent policy would be complemented and strengthened by IMF requirements for economic data and conditionality on Fund programs for Eastern European members. The U.S. should therefore reaffirm its policy of supporting the membership in the IMF of any country which accepts the obligations of membership, since it would reinforce longstanding U.S. policy of resisting politicization of the Fund and strengthening the hand of those officials in Eastern Europe who advocate economic reforms.

Because Western lending to Eastern European countries includes both official (government-backed) and private commercial bank lending, a differentiation policy on credits must take both phenomena into account along with their relative importance in East-West trade financing. The terms of reference approved by the President for the Buckley mission directed us to seek restrictions on credits and guarantees to the Soviet Union only.

Official Lending. Official direct and guaranteed lending accounts for a widely divergent share of U.S. exposure in individual CEMA countries: 60% in Poland but a relatively small share for the other Warsaw Pact countries eligible for official U.S. credits. However, the share of government-backed credit in total lending to Eastern Europe could grow substantially in the next few years if the cutback in private bank lending

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continues. Although commercial and creditworthiness considerations have played the main role in government lending decisions, political factors have also been important. This political influence in decisions to lend to Eastern Europe is probably inevitable.

That should not mean, however, that a thorough and objective creditworthiness evaluation should not continue to be a key criteria for official lending decisions. What it does mean is that within the framework of economic criteria, foreign policy factors may play a significant role in deciding whether or not credits are to be extended to a specific East European country.

Interest rates, terms, and conditions of official and government guaranteed loans should be set in accordance with prevailing market conditions. As a matter of principal, there should be minimum subsidization of interest rates. Multilateral agreements (e.g. the OECD Credit Arrangement) is necessary to ensure the efficacy of these conditions and prevent any country from gaining commercial advantage by the circumvention.

Commercial Bank Lending. It is USG policy that lending decision of commercial banks should be made by the banks themselves without government intervention: the banks have the expertise best to make this judgment, and they bear full responsibility for their actions. Extension of credit to individual countries involves a host of considerations extending beyond the evaluation of transfer risk that only the banks are in a position to assess. Further, bank officers and directors have a legal and moral responsibility to their stockholders and depositors for the funds placed in their trust. All of these arguments militate against the U.S. Government attempting to influence directly the flow of credit.

However, the USG differentiation policy toward Eastern Europe and USG-Soviet relations in general establish the climate in which private sector lending takes place. The former more favorable official policy climate fostered private bank lending, for example, and current strains in US-Soviet relations are producing the reverse effect. The USG, therefore, has a responsibility to enunciate clearly to the private sector its differentiation policy as it applies to

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specific countries and be prepared to back up explanations with jawboning and the use of official credits and credit guarantees if necessary and appropriate.

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C. IMF MEMBERSHIP

The traditional approach by the United States to membership in the IMF has been to support widespread participation in the institution, so long as applicants for membership are prepared to undertake the obligations of membership. This approach reflects the following considerations:

- Widespread participation strengthens the IMF's ability to promote the open, stable international financial and economic system essential to the achievement of U.S. domestic economic and foreign policy objectives.
- The basic IMF approach to economic issues is supportive of Western economic philosophies and practices. Consequently, widespread membership encourages adoption of economic policies compatible with the open, market-oriented systems of the Western industrial nations.
- The membership of the IMF includes a wide diversity of countries. A general approach to membership which focused on political "suitability" as a guiding criteria could lead to politicization of other IMF activities -- for example, decisions on financing -- which could undermine the Fund's ability to promote sound economic policies and members' willingness to meet their IMF obligations.

Similar considerations underlie the approach of the other major countries to IMF membership questions. Decisions on membership require a simple majority vote (weighted), and the U.S., with roughly 20 percent of the voting power, would need to obtain the support of a number of countries on a continuing basis to implement successfully a general policy of political selectivity on membership questions. It would probably be extremely difficult to obtain such support and could be costly in terms of other U.S. objectives.

Nevertheless, basic membership questions inherently involve political judgments and questions that do not normally arise in the course of applying the institution's rules uniformly to countries that have already been accepted into membership. The U.S. does consider each request for membership on a case-by-case basis and decides such requests on the basis of a careful review

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of all factors. There may be specific cases in which U.S. interests in other areas will outweigh the general factors noted above, and the United States should continue to review each application for membership on an individual basis in light of all U.S. interests and the circumstances of each case, including the attitudes of other major IMF members.

In this regard, the U.S. recently supported the IMF Executive Board's recommendation to governors that Hungary's application be approved. At this point, Poland's application appears to be on hold and there are no other Eastern European countries likely to apply for membership in the foreseeable future. Thus, in practice, there is little likelihood that we will have to make any decisions anytime soon regarding IMF membership as an instrument of differentiation.

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Issue. Whether to apply a policy of differentiation in concessional sales of foodstuffs to the countries of Eastern Europe, and whether such a policy could be implemented under current U.S. law.

Discussion. The U.S. has been involved in providing concessional food sales to Poland under PL-480 Title II since 1956 when Poland was determined to be a "friendly country" under the terms of the Act by Secretary of State Dulles. Between 1956 and 1974, about \$520 million in such sales for local currency were granted to Poland. Poland's eligibility for PL-480 funding was reaffirmed by Secretary Haig in 1981 prior to granting \$55 million in PL-480 Title I credits. Finally, PL-480 Title II food grants to private relief agencies for distribution in Poland are still underway, with \$30 million of such aid approved to date.

Current U.S. policy is to provide long-term concessional credits under PL-480 Title I to finance the importation of U.S. agricultural commodities by friendly developing countries. The amount of such credits to a particular country, as well as the terms of repayment (initial payment, interest rate, grace period, term) reflect the recipient's needs and ability to repay. The law requires that a minimum of 75 percent of Title I commodities be allocated to countries with a per capita income of not more than \$730, in accordance with the IDA's current poverty criterion. In view of the high per capita GNP in the Eastern European countries, major programming in Eastern Europe would require difficult policy choices on allocation of limited resources to countries such as Morocco, Jamaica, Costa Rica, Tunisia, Mauritius, Peru and the Dominican Republic.

Our policy of not providing food aid to wealthier countries has helped us manage recipient country pressures for Title I in the face of budget stringency, since worldwide demand for U.S. concessional food sales far exceeds the available budget.

Current policy is not to engage in concessional food sales to Eastern Europe or other countries with similar GNP levels, but rather to offer U.S. agricultural exports on a cash basis, supported by CCC credit guarantees as appropriate. Such sales would discriminate against other countries of similar GNP levels which do not receive Title I at present (e.g., Portugal and Korea) and would negate efforts to phase out other less needy recipients.

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Section 103(d) and 103(j) of PL-480 limit PL-480 programming to "friendly" countries. With the exception of Poland, the East European countries have been considered to be outside the definition of "friendly" as defined in PL-480, adding to the reasons why such assistance has not been provided to them over time. In the case of China, the decision was made to seek a legislative amendment establishing eligibility. Congressional consultations would be required to decide the appropriate way to deal with this issue for the countries of Eastern Europe.

Congressional perceptions and the Executive Branch's assessment of the human rights situation in each East European country may require that serious consideration be given to including human rights language in any PL-480 agreement, in accordance with Section 112 of PL-480. This provision requires that either the commodities themselves or the proceeds from their sale be used for specific, agreed upon projects or programs which will directly benefit the needy. Poland agreed to such provisions in its Title I sales contract in 1981 but in general this requirement is politically sensitive to PL-480 recipient governments and may prove unacceptable to the East European countries.

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SECRET/SENSITIVEE. DEBT RESCHEDULING

The policy of the U.S. has been to extend debt relief only when it can be justified financially. While political or security objectives may influence our eagerness to provide relief and the terms we are willing to accept, our action must be defensible on financial grounds.

Our traditional approach to rescheduling has been largely reactive in that we decide to reschedule (generally in the multilateral context of the Paris Club) following a formal request by the country concerned and a USG determination that the country is in "imminent default" (i.e. it will not have sufficient foreign exchange to meet its external debt servicing obligations and, therefore, rescheduling offers the only hope of being repaid). We also generally insist on IMF approval of the country's economic adjustment program before negotiating a debt relief agreement; the purpose of this condition is to ensure that our debt relief is not wasted. In sum, the USG and other governments have almost always based rescheduling decisions on financial criteria.

As is the case with most other issues in East-West economic relations, political factors have been, and will inevitably continue to be, given a far greater weight in U.S. decision-making on rescheduling of the debts of the Eastern European countries.

In the case of Poland, our position has changed radically in reaction to political developments there, reflecting a shift from the positive to the negative aspects of our differentiation policy. Poland's external debt is a massive \$26 billion. Official creditors rescheduled \$2.3 billion in debt service payments due in 1981 and provided Poland with substantial new credits. Our decision to join in the rescheduling was based primarily on economic factors; the terms of the rescheduling plus the successive decisions to provide credits were determined in connection with political objectives reflecting our differentiation policy. Our objective was to weaken a major pillar of the Warsaw Pact by: (1) helping to insure that the nascent liberalization process did not founder on the shoals of economic disruption; and (2) encouraging the establishment of a more Western-oriented economic structure in Poland through the implementation of far-reaching economic reforms. In pursuit of the latter objective, the Western

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governments kept Poland on a short economic leash, agreeing to reschedule Polish debt at only six-month intervals and conditioning successive rescheduling agreements on the implementation of the economic reform program which the Government of Poland was to implement in January 1982.

With the imposition of martial law in December 1981, the NATO Alliance agreed to suspend discussions on rescheduling of Poland's 1982 debt pending: (1) lifting of martial law; (2) the release of political prisoners; and (3) the restoration of a meaningful dialogue between the government, the Church and Solidarity. The continued refusal to reschedule will increase the risk of a Polish default and will drive Poland closer to the Soviet Union. However, it is not clear that dropping the three conditions and agreeing to reschedule would lead to a favorable evolution of the Polish political situation. By itself rescheduling would appear to be a weak political instrument viewed in a narrow perspective of the Polish situation, but its utility as a part of a broader strategy should be explored. The most we might have expected would have been Polish adoption of economic reforms in response to our conditions for rescheduling.

Regarding the other countries of Eastern Europe, if differentiation were the sole or overriding criterion, we would be more receptive to requests for rescheduling assistance from Hungary and Romania in solving their debt problems, and negative toward the GDR. (Czechoslovakia and Bulgaria are in reasonably healthy financial positions and are not likely to require such assistance in the foreseeable future.)

The weakening of the Warsaw Pact, the paramount goal we are pursuing through differentiation is, and will inevitably continue to be, an important factor in deciding what position to take on a rescheduling or other request for financial assistance from an Eastern European country. Other priority U.S. economic and political objectives, some of which may conflict with those of our differentiation policy, also will be weighed. The question is in each case what are the relative weights to be assigned to each in arriving at a final position.

Our position that it is premature to consider rescheduling Romania's debt clearly illustrates these points. While at about \$10.7 billion, Romania's external debt is far smaller than Poland's, Romania experienced severe liquidity problems in recent months, building over \$1.0 billion in arrears to private creditors. Responding to informal soundings by the GOR on an official rescheduling, all official creditors, with the

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exception of the U.S., have agreed to proceed. (The GOR has recently formalized the request.) The U.S. has indicated that it would be premature to make a decision on an official rescheduling until the IMF Executive Board has approved of a new lending program for Romania. In effect, we have followed our normal practice of conditioning our participation in rescheduling Romania's debt on the GOR's getting its economic house in order.

There are arguments for and against our agreeing to proceed with a Paris Club rescheduling of Romania. One argument in favor is that the financial considerations involved would increase the chances of being repaid. Indications are that banks will not reschedule in the absence of an official rescheduling. Moreover, the IMF staff will not send its now approved lending program to the Executive Board unless they are certain that Romania's official and private debt will be rescheduled.

There are political reasons for rescheduling Romania's debt. A decision not to reschedule could be viewed by the GOR as a political decision calculated to downgrade sharply the bilateral relationship, and would drive Romania toward a much closer economic, and therefore political, relationship with the USSR. Therefore, a rescheduling would help the GOR to maintain a relatively independent foreign policy and its quasi arms-length relationship with the Warsaw Pact. Thus a decision to reschedule Romanian debt while continuing to hold back on Poland would constitute a powerful statement on differentiation. It would also help lift the veil of political uncertainty which is adversely affecting the implementing of a policy of differentiation.

There are also political and potential economic costs to rescheduling. However, the degree of cooperation we receive from the Europeans on other important aspects of East-West financial relations (e.g., restricting credits to the USSR) may help reduce the political costs and thus increase our flexibility. On the economic side, an argument against rescheduling is that there is a potential danger that the rescheduling will enable Romania to obtain credit from the IMF and possibly from the private sector, which could be diverted to the USSR, which is also experiencing a financial squeeze. Given Romania's financial pinch and its political/economic relations with the Soviet Union, such diversion is unlikely, but it cannot be ruled out.

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We should be aware that moving slowly on the Romanian rescheduling while we weigh other political/economic considerations carries risks. For example, the credit/USSR process may play out slowly and still not bear fruit. But we will have to make decisions relatively soon on rescheduling. Thus, through inaction we may sacrifice differentiation and receive nothing in return.

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In the past, despite the stated policy of differentiating in relations with Eastern Europe, there has been little significant reflection of this policy in the administration of security export controls towards individual East European countries. Until January 1980, the United States controlled exports of strategic goods and technology:

- (a) to Albania, Bulgaria, Czechoslovakia, and the GDR on substantially the same basis as to the USSR;
- (b) to Hungary and Poland on the basis of a largely cosmetic favorable differentiation in controls; and
- (c) to Romania on only a marginally more liberal basis, even though overall US policy was markedly more favorable in recognition of Romania's relatively independent foreign policy

The March 1980 "no exceptions" policy on exports to the USSR and December 30, 1981 suspension of all licensing of controlled exports to the USSR did not apply to other Warsaw Pact countries. On the other hand, the March 1982 suspension of licensing of exports to Poland removed security export differentiation between the USSR and Poland. Moreover, differentiation has also been reduced significantly in practice during the past two years by denial of US cases and US objections in COCOM to types of cases for the other Eastern European Warsaw Pact countries which had been previously approved.

In 1957 COCOM agreed to a special Polish procedure which was supposed to permit more liberal treatment of exceptions cases for that country, but there has been little substantive effect from that procedure. In 1967 and 1978 COCOM agreed de facto with the substance of US proposals for more liberal treatment of Romania. However, France opposed recording such an agreement in a COCOM document and US actions on COCOM Romanian cases have been virtually as restrictive as for other Eastern European countries.

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Objectives of Differentiation

Differentiation in the application of export controls is one of the few options available for giving tangible, continuing substance to such overall differential policy as may be politically justified: for example, (1) encouragement of Eastern European regional differences from the USSR and (2) support for (a) Romania's increasing independence of the Soviet Union in both foreign policy and military activities and (b) Hungary's domestic economic liberalization and increasing ties to the West. The arguments for a clear differential policy in technology transfer are the same ones as those for a general differential policy. They include encouraging more independent policies within Eastern Europe, building up the economic base of certain countries in order to lessen the dependence on the USSR, and encouraging "quasi-capitalistic" experiments (joint ventures, Western equity positions, etc). The arguments against a differential policy vary from intentionally pushing weak economies towards the USSR to increase the Soviet economic problems (umbrella theory) to the unadvisability of increasing the Warsaw Pact's military growth and industrial capabilities through transfers of military-related high technology.

Limits of Differentiation

Differentiation on export controls to Eastern Europe risks diversion of equipment and technology both to the USSR and to military activities in the individual Eastern European countries. The most effective safeguard against diversion is to limit technology transfers to an acceptable strategic level. This risk is particularly serious with regard to transfer of technology which is often difficult to protect in the best of circumstances. This coupled with the strong evidence of cooperative efforts of the intelligence services of the Soviet Union and several Eastern European countries argues strongly against the inclusion of significant military relevant technology transfer in the application of any export control differentiation policy. On the other hand, there has been little evidence in recent years suggesting diversion to the USSR of embargoed equipment purchased legally by East European countries, but this could be partly attributable to the modest scope of differentiation in the administration of controls. The risk of diversion to the USSR is lower from some countries, e.g., Romania, than from others, e.g., the GDR. The risk of diversion could be further reduced through cooperation from the Eastern European governments concerned. For example, Hungarian officials informally advised us that they would be prepared to

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provide information about production links with the USSR which would allow us to evaluate that problem in individual cases. We should proceed to test this offer.

We might also explore the possibility of an agreement with the Hungarian government concerning: (1) where feasible, Post shipment verifications by US officials; (2) Hungarian government controls on reexports of specified items unless approved by the US; and (3) Hungarian assistance to the United States in the investigation of alleged diversions. We could also inquire whether other Eastern European governments would enter into such undertakings in return for a more liberal export licensing policy expressed in terms of specific items.

Differentiation requires COCOM recognition that approvals for one country do not necessarily constitute precedents for approvals to other proscribed destinations: This has been achieved as a general principle by a 1978 amendment to the exceptions procedures which permits taking international political factors into consideration.

Extent of Differentiation

One of the criticisms of our export control system has been the lack of clarity and predictability. Previous administrations have articulated a differential policy based on a Presidential Directive but specific examples of a preferential treatment practice despite this, are hard to document. The export license processing bureaucracy has tended to view Eastern European countries primarily in light of their Warsaw Pact affiliation. Any policy which intends a more substantial differential must therefore be articulated clearly in technical terms.

History shows that, without an understanding of what is to be approved to one country and not to another, a differential policy is largely devoid of substance. One possibility could be a series of Eastern European notes similar to the "two times" formula Notes which now apply to China.

License applications should not automatically be denied to end-users in Eastern Europe that may somehow be engaged in both military and civilian production. The criteria used in individual cases should be whether the specific proposed export could contribute significantly to enhancing military production and whether there is a likelihood that a diversion to such activity might occur.

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At the COCOM High Level Meeting the member governments agreed that in considering embargo coverage of "critical military technologies" the Committee would take "particular account of information available on the priority defense industries in the Warsaw Pact countries." It is appropriate, therefore, that case review for Eastern Europe involve a consideration of the potential impact of proposed exports on those defense priority industries.

To help clarify USG policy, there is a need for clear policy guidelines.

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G. COMMERCIAL POLICY AS AN INSTRUMENT OF DIFFERENTIATION

The United States has employed a number of commercial policy instruments to influence the development of bilateral trade relations with the non-Soviet Warsaw Pact countries. Relations with Romania, Hungary, and Poland (until the imposition of martial law) were broadened significantly by application of these instruments, thereby reinforcing MFN and other actions (e.g., credit extension) associated with differentiation. Similarly, we have used some of these techniques with Bulgaria, Czechoslovakia and the GDR, countries not receiving MFN, to achieve a more modest expansion of commercial relations.

Bilateral Agreements. In addition to having concluded trade agreements providing for reciprocal MFN treatment with Hungary and Romania, the United States has entered into numerous other bilateral agreements with CMEA countries. These include agreements on: long-term cooperation (Romania); double taxation avoidance (Romania, Hungary, and Poland); maritime transport (Romania and Bulgaria); textiles (Romania and Poland); fisheries (Romania, Bulgaria, Poland and the GDR); science and technology cooperation (Bulgaria, Hungary, and Poland); and civil aviation (Poland, Romania, Czechoslovakia and Hungary). In addition, the Department of Agriculture has negotiated agricultural trade and cooperation agreements with Poland, Romania, Bulgaria and Hungary. There are preliminary signs of GDR interest in an agreement.

Our willingness to sign these agreements was based not only on our desire to improve our relations with these countries, but also to serve particular U.S. interests, such as the growth of industrial cooperation and investment activities in Romania, Hungary, and Poland, which led to the double taxation avoidance treaties.

The implementation of these agreements provides opportunities to reinforce our differentiation policies. Both our textile and fisheries agreements contain quota levels for certain textile and fish catch categories respectively, which are adjusted annually and which can be used in support of our interests. For example, following the imposition of martial law in Poland, we suspended Polish fishing rights in U.S. waters.

By renewing individual agreements we can demonstrate our continuing interest in differentiation or, conversely, withdraw our support in selected areas. New economic or commercial agreements might be used to implement our policies toward individual East European countries.

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Economic and Commercial Commissions. The United States has established joint trade commissions with three Eastern European countries (Poland, Romania and Hungary) to guide trade relations through a governmental framework, to review trade issues and to seek resolution of economic and commercial problems. The scheduling of commission meetings and frequency of commission activities between sessions allow us to modulate our differentiation policy. Commission meetings themselves provide a forum to press our views on Polish, Romanian and Hungarian policies and practices.

Trade and Economic Councils. In addition to the three joint governmental commissions, private trade and economic councils have been established by the United States with each of the six East European countries. The councils have varied greatly in their degree of activity, usually in proportion to the amount of bilateral trade or level of bilateral relations. USG support for and participation in the council meetings usually reflects the degree to which we differentiate that country from others in Eastern Europe, greater support being given to the Romanian and Hungarian Councils, and in the past to the Polish Council.

Trade Promotion. The Department of Commerce sponsors official American participation in annual exhibitions in every Eastern European CMEA country. In 1981, U.S. company off-the-floor sales at these events totalled \$10 million. Other official trade promotion events in the past few years have included technical sales seminars and video catalog exhibitions on specific industrial themes. Trade promotion events have been used as an instrument of differentiation. We have expanded participation in East European trade fairs and increased the number of our own seminars and shows to demonstrate our interest in developing relations. We also have facilitated East European trade missions to the United States. On the other hand, we have withdrawn our support for such events and programs, as has been done in Poland and the USSR, in response to political actions of which we strongly disapprove.

The USG has operated overseas trade promotion facilities in Warsaw, Budapest and Prague, which have enabled U.S. companies to market successfully their products. To the extent we find expanded trade relations helpful, they could be increased.

East European Offices in the United States. To date, 15 offices outside Washington have been authorized for East European official commercial and banking representations, as well as tourist promotion. The authorization for such offices

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and their operating conditions can be used to support differentiation objectives.

CONCLUSION

-- We should continue to use bilateral agreements, economic commissions, trade and economic councils, trade promotion and the establishment of East European offices in the U.S. as instruments of differentiation.

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SECRET/SENSITIVEH. Cultural and Scholarly Exchanges and
Information Policies

The activities of the U. S. International Communication Agency in East Europe fall into five categories: international broadcasting (VOA), the operation of libraries and cultural centers, programs of academic exchange and specialist visits, information distribution including magazine publication and the programming of speakers, and cultural exchange programs such as exhibits and performing arts. With the exception of broadcasting, these activities take place both within formal bilateral agreements and negotiated biennial programs of exchange (Hungary, Romania and Bulgaria) and without such formal instruments (GDR, Czechoslovakia, and Poland). Taken together, ICA's program is a major effort in public diplomacy to communicate U.S. policies and American ideas and perceptions by providing "a window on America" for the people of the closed societies of East Europe.

Excepting the Voice of America, which broadcasts "over the heads" of governments directly to its listeners, ICA activities in Eastern Europe are the beneficiaries of positive differentiation, expanding to a position of greater access to publics where the U.S. relationship is perceived as positive, and operating to a more limited extent where the U.S. relationship is seen as less positive. Since ICA's public diplomacy effort in East Europe is directed toward people and not governments, it exists with the sufferance of authorities who display toward it degrees of hostility, tolerance and cooperation reflecting the leadership's perception of the U.S. relationship. The breadth of USICA activities provides our officers with extraordinary access to East European societies. An active program, and the opportunities for personal contact with intellectual elites and larger publics which it represents, provides a unique opening for U.S. policy. Differentiated relationships are, then critical to the ability of USICA to wage actively the battle of ideas on behalf of the national interest "on-the-ground" in communist East Europe.

USICA activities in East Europe, are designed to serve the U.S. national interest. They represent "instruments for implementing differentiation" only to a limited extent. ICA's academic exchange programs, for example, enhance U.S. security by: a) providing insights into work underway at East European academic research institutes; b) developing a "successor generation"

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cadre of American specialists fluent with East European history, languages and policies; c) forming continuing contacts between American and East European intellectual and scholarly peers; and d) establishing links between academic institutions as an alternative for East Europeans to closer Soviet bonds.

USICA programs such as exhibits, performing arts, speakers, magazine and policy information distribution, as well as our operation of libraries and cultural centers provide the U.S. with the opportunity to communicate directly with East European publics on behalf of democratic ideas, free enterprise, and Administration policy. In this sense, these activities cannot be described with complete accuracy as "carrots" with which to reward acceptable behavior nor as aspects of a relationship which would, by withdrawal, meaningfully penalize hostile governments. The U.S. security gain which derives from a full, direct and active encounter between American ideas, views, and accomplishments and the people of East Europe far outweighs the possible "punishment" which depriving East Europeans of these programs would inflict on governments.

With academic exchange programs as a basis, however, the option to conclude formal bilateral agreements of cultural exchange with the governments of East Europe is an important tool with which to differentiate between regimes which meet our criteria and those which do not. Formal programs of exchange are often sought by governments as further legitimization and as a statement of their bilateral relationship with the U.S. Our preference has been, and continues to be, to operate without formal agreements, entering into them only as a statement of policy when recommended by the Department of State and, in addition, where we judge USICA activities to be limited unacceptably without an agreement.

The Voice of America's East European language services reflect VOA's world-wide mission: to broadcast, with truth and accuracy, news and information about international events, about America, as well as statements of U.S. foreign policy as articulated by the President and his Administration on global issues.

The Voice of America can differentiate among its broadcasts to the various countries of Eastern Europe by adjusting the relative proportion of news, commentary and feature material, or by increasing or decreasing the total hours of broadcasting and frequencies used to reach a particular audience. This is especially true in times of crisis.

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The policy content of VOA broadcasts closely mirrors the public U.S. positions articulated by the President and his policy spokesmen. VOA differentiates among the East European nations in policy terms, therefore, only to the extent that the U.S. government does likewise.

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SECRET/SENSITIVEI. SCIENTIFIC EXCHANGES

We have differentiated between the USSR and EE and among EE countries in S&T relations on the basis of (1) the value to the US of scientific cooperation, (2) the political value to the US of using S&T cooperation to encourage openings to the West, and (3) the political and intelligence value of good access to their S&T establishments, which often are important elements in those societies and whose members are becoming increasingly important as political leaders.

The USG S&T program provides a number of means to support the policy of differentiation toward the USSR and EE. The form of the relationship ranges from individual memoranda of understanding between interested agencies, through the inclusion of an S&T component in a general exchanges or cultural agreement, to a government-to-government level S&T agreement. One factor in the choice of form is degree to which we wish to show government approval for conducting this activity with the particular country.

Other aspects of the mechanics of these programs give us the means not only to differentiate among countries but also to take timely actions to improve the balance of benefits to the US. We can work to ensure reciprocity and mutual benefit by controlling the number, duration, and itineraries of visits in both directions. We can oversee the choice, number, and content of projects and activities, and we can, if necessary, postpone meetings whose purpose is to agree on work programs for the coming year or two. All of these are controls that can be exercised for political reasons, but such exercise of those controls is not costless. To the extent that projects represent research and other activities of benefit to the US side, including USG agencies, it is harmful to slow them down. To the extent that private institutions and scientists are involved, we run some public relations risks in attempting to control the flow of information and travel of scientists for political purposes.

Finally, it should be noted that close government supervision of these programs enables us to address questions of technology transfer both early and on a regular basis in the exchanges. The US intelligence community plays an important role in this process. While some technology transferred to EE countries has made its way to the Soviet Union, we have found no evidence that sensitive technology has leaked through official USG bilateral S&T programs.

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Until recently our most extensive and productive EE programs were with Poland. After martial law was imposed in December 1981, we cut down the level of activity as a signal of our displeasure: we suspended the process of approving a new S&T agreement, allowed the 1974 Agreement to lapse, cut the travel of American scientists down to the minimum necessary to keep approved projects alive, and turned aside a Polish proposal to hold a meeting of the Joint Board which oversees the program. As we intended, the Poles understood these actions to be another manifestation of US displeasure over the course of events in Poland. Cutting back official S&T cooperation was a useful signal at low cost to the US.

Our S&T relations with Hungary and Romania go together with -- and reward -- their willingness to distance themselves from some aspects of Soviet policies. To a lesser extent some increase in S&T cooperation with Bulgaria has come about because of a slight thaw in relations as perceived by the Embassy in Sofia. In a number of fields the cooperation has produced useful scientific data and analyses, but the primary justification for the programs is political. (Under these circumstances it is difficult to avoid political overtones on actions caused by budget reductions, such as a reduction in levels of activity and the abolition of the Science Attache position in Bucharest.) By the same intent, our S&T relations with East Germany and Czechoslovakia are minimal and we, along with ICA, have not acted to initiate negotiations toward cultural and scientific exchange agreements with them.

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SECRET/SENSITIVEJ. HIGH LEVEL VISITS, SHIP VISITS, CONSULTATIONS

Sending and receiving high-level visitors is one of the clearest and most highly visible means available of indicating the state of relations with other countries. It is particularly useful with the East European regimes. Such visits have played a key role in the development of U.S. relations with Romania, Hungary, and Poland before the imposition of martial law, and they are an important tool in achieving the broad aims of U.S. policy in the area. They serve both as recognition of and encouragement to those regimes which have shown the ability in their internal and external policies to act independently of the Soviet Union.

Frank discussions with East European leaders, such as Hungary's Kadar or Romania's Ceausescu, who are close enough to the USSR to offer a unique view of the Soviet leadership's thinking yet independent-minded enough to understand Western concerns, are valuable for U.S. policy makers. These contacts can encourage an understanding of the U.S. among these leaders and provide opportunities to broaden contacts on a wide range of issues in the political, economic and cultural fields. The Polish Government's decision not to suppress Solidarity at its birth, the development of the market-oriented New Economic Mechanism in Hungary, and the independent foreign policy in Romania over the past decade all received encouragement from Western leaders at critical moments through high-level contacts. The importance which East European leaders place on personal contact with U.S. leaders has been demonstrated by the efforts which East Germany, Czechoslovakia, and particularly Bulgaria have made to bring about such meetings between their leaders and top American officials. The U.S. for its part is awaiting evidence from these three regimes that they are able and willing to detach themselves to a degree from their extremely close identification with Soviet policies and to live up more fully to their obligations under the Helsinki Act.

The U.S. Government has made limited use of visits by naval vessels as a means of encouraging an independent attitude in East Europe. They allow us to show the flag and demonstrate that the U.S. has as much right in the Baltic and the Black Seas as the Soviets. The only Warsaw Pact nation with

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sufficient independence and self-confidence to receive U.S. Naval calls to date has been Romania. Calls at Romania's Black Sea ports by the U.S. Navy have been an important symbol of Romania's foreign policy independence, and it is to be hoped that developments in other Pact countries will provide opportunities to initiate similar programs elsewhere in the region. We have also practiced differentiation in our dealings with Warsaw Pact military representatives, both at their embassies in Washington and in East Europe. In addition, high level military visits also provide a useful vehicle for indicating U.S. policy concerns when appropriate

In addition to sending and receiving high-level delegations and port visits, the U.S. carries out regularly scheduled, working-level political consultation with a number of countries in the area. These non-protocolary visits are designed to permit the frankest possible airing of views by the participants. They are not freighted with political symbolism of Presidential or Cabinet-level discussions and are one of the principal means by which governments, such as Bulgaria, which often exhibit a determinedly hazy understanding of U.S. policy, can be given full exposure to U.S. position on a wide range of issues. Working-level consultations may be used to work toward high-level contacts when they are deemed desirable, or to put the brakes on such initiatives when they are not.

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CONFIDENTIALK. ACTIVITIES IN INTERNATIONAL FORA

The Eastern European countries vote with the Soviet Union and serves as its faithful agents in UN bodies. We have assumed that they have little choice in the positions they take and that US diplomatic efforts to persuade some of them to take positions independent of the Soviet Union would be futile. The only possible exception to this rule is Romania, which has on rare occasions taken different stands than the USSR on minor resolutions on arms control and other insignificant matters in the UN General Assembly. We have, in general, tried to avoid statements in UN bodies that identify the Eastern European countries as Soviet satellites. We avoid direct attacks on them unless they attack the US.

We have moved on several fronts within the UN system to direct attention within the UN system to the military crackdown in Poland. In mid-December 1982, we urged the Secretary General, the Director of the UN Human Rights Commission and the Director General of the ILO to make appeals to the Polish authorities to cease violations of human rights. Secretary General Waldheim made such an appeal to Warsaw and "all others concerned to exercise restraint," but he indicated that he regarded the situation in Poland as a domestic matter. Waldheim's successor, Perez de Cuellar, made somewhat stronger statements of concern in January although he too characterizes the situation as a domestic matter.

The ILO has responded vigorously to the martial law crackdown in Poland. Director General Blanchard requested Polish authorities to approve travel of an ILO fact-finding team. This was refused, but Poland countered with a proposal to send representatives to explain the situation in Poland. On January 23 Secretary Haig sent a follow-up letter to Blanchard expressing U.S. concern over the violation of worker rights in Poland. The ILO Committee on Freedom of Association recommended that Poland formally be called upon to accept a fact-finding mission. This was adopted on March 5 by the ILO Governing Body. The ILO requested information on reestablishing trade unions, internment of Solidarity members, criminal charges against strikers, and anti-union discrimination in employment. It also requested an inquiry into worker deaths at the Wujek Mine. Though they argued strenuously against the measure, the Soviets in the end did not call for a vote. The situation in Poland is on the agenda of the Governing Body in May and the annual Conference in June. The Conference will also reconsider

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the Soviet Union's application of freedom of association, since last year's routine consideration left some questions unanswered. This year the USSR is further scheduled to report on its compliance with the forced labor conventions. Non-discrimination in employment in Czechoslovakia will also be reconsidered. (While all Soviet Bloc countries can be faulted on these conventions, the understanding has been that it is more fruitful to examine selected country practices than to criticize the Bloc as a whole.)

Pressure was also brought on Poland in the Human Rights Commission. At U.S. instigation, and despite the best efforts of the USSR, the 38th UNHRC adopted a resolution on March 10 which expressed its deep concern over the widespread violations of human rights and fundamental freedoms in Poland. The resolution affirmed the right of the Polish people to pursue their political and economic development, free from outside interference. It called for the end of measures restricting human rights and fundamental freedoms, release of prisoners detained without charge, and a review of sentences imposed under martial law. The resolution also requested the Secretary General to undertake a thorough study of the human rights situation in Poland and present a comprehensive report to the next annual session of the Commission.

Such action by the UNHRC itself demonstrates that we and the community of nations can hold the Soviet Union and Eastern Europe up to censure for failure to comply with international obligations. The UNHRC action clearly treated Poland as a sovereign and independent country; the resolution's emphasis on freedom from all outside interference certainly demonstrated this.

The U.S. is prepared to join with our Allies in seeking Security Council action if the USSR employed its own military forces in Poland. We would expect strong support for action against the Soviets in this event, and although the Soviets would cast a veto, this could set the stage for an Emergency Special Session of the UN General Assembly for the purpose of condemning Soviet aggression. We have not sought to convene the Council in response to the imposition of martial law by the Polish government because of lack of support from friendly and Allied members on the Council for this. There is general concern that it might be difficult to present a compelling case of a situation endangering international peace under the UN Charter which would be necessary to justify the Council's jurisdiction; also, we are concerned that even if we could obtain the necessary nine procedural votes to inscribe Poland on the UNSC agenda and hold a debate, the Soviets might be able to block the nine vote majority needed to force a veto of any substantive action by the Council, thus vindicating their position.

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The threat of UN censure of overt Soviet aggression in Poland would not alone deter a Soviet invasion, but knowledge that action in the UN would further isolate it politically in international bodies, as the invasion of Afghanistan did, is one of many deterrent factors.

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L. RESTRICTIONS ON EASTERN EUROPEAN DIPLOMATIC
AND CONSULAR PERSONNEL

Historically, the United States has supported the maximum allowable freedom for diplomats, both U.S. and foreign, in the exercise of their duties. This principle has been embodied in the Vienna Convention on Diplomatic Relations of 1961 to which the U.S. is a signatory. Recent events in Iran strengthened the U.S. commitment to protection of diplomatic privileges and immunities.

The United States has also historically supported the principle of diplomatic and consular reciprocity. We have afforded other countries the same diplomatic privileges that they have accorded our diplomatic and consular personnel.

Thus we have only limited the freedom of foreign diplomats in this country in response to limitations placed on our diplomats in a foreign country. This same principle has been applied to the issuance of visas, both diplomatic and non-diplomatic. We stand for the maximum possible freedom of movement of people both between countries and within countries.

At this time no Eastern European country imposes travel restrictions on American diplomatic and consular personnel. There are, of course, certain military areas that are considered off limits, but otherwise travel in and through Poland, East Germany, Czechoslovakia, Hungary, Romania and Bulgaria is relatively unhindered. It is safe to say that if the U.S. were to impose restrictions on diplomats from any of these countries for whatever reason, they would quickly and effectively impose similar restrictions on American diplomats.

The U.S. is at a disadvantage in enforcing travel restrictions on diplomats simply because we do not have internal travel controls found in most Eastern European countries. We, of course, have no desire to match the pervasive police influence found in these communist systems, but we cannot hope to be as uniformly restrictive as they would be able to be.

Both on the grounds of principle and of practicality, imposition of travel restrictions against Eastern European diplomats in the United States would seem to be an unpromising avenue. We should impose such restrictions only on the grounds of reciprocity and even while doing so we should be seeking to

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return to normal travel freedom and should recognize that our restrictions will not be as effectively enforced as those of the opposing side.

The U.S. could impose restrictions on the number of Eastern European diplomats accredited in the U.S. Doing so would certainly lead to reciprocal action by the other side. Given the much greater openness of our society, and the more important role our diplomatic personnel play in gathering information on developments in these countries, such actions would have to be very carefully evaluated to ensure that they did not hurt us more than the other side.

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SECRETV. ALLIED COOPERATION

The relaxation of East-West tensions during the last decade, symbolized by the Quadripartite Agreement on Berlin, the CSCE accords and the SALT talks, psychologically reinforced West European inhibitions about confrontation with the USSR. Even though their apprehensions about Soviet intentions appear to be increasing, the Europeans seek to avoid a return to the rigid bipolarism of the 1950s.

U.S. Differentiation. Turning to the specific issue of differentiation, a fundamental point of departure is the distinction between the Soviet Union and Eastern Europe and, indeed, among the countries of Eastern Europe themselves. In relations with the Warsaw Pact countries of Eastern Europe, we have sought to encourage evolutionary change toward greater diversity and national independence. We have done so from the conviction that this approach will serve best our interest in peace and stability in Europe, reflect our concern for the peoples of Eastern Europe and support trade and other forms of economic cooperation there. We have differentiated among these countries to the degree that they pursue independent foreign policies and/or more liberal domestic policies.

European Differentiation. Our European Allies also support the proposition that a peaceful Eastern Europe, which is engaged in constructive interaction with the rest of Europe, can be a force for stability. They have strengthened bilateral relations, particularly in the economic, cultural and social fields, with the Eastern European countries in the belief that this could contribute to securing cooperation rather than confrontation in Europe. They generally have been ahead of us in differentiating among the various countries of Eastern Europe during much of the post-World War II period. However, our European Allies understand that the concept of differentiation has two discrete, if related, aspects. They have supported differentiation as a means of influencing change and encouraging acceptable behavior in Eastern Europe. They are less inclined toward differentiation as a vehicle for anti-Soviet activities likely to increase East-West tensions.

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Allied Response to U.S. Policy. We can reasonably expect then that the Allies would be inclined to support us on differentiation toward Eastern Europe if they perceive this as directed primarily at the Eastern Europeans and not as surrogate anti-Soviet activity. On the other hand, we can expect difficulties with the Allies if we choose not to follow a policy of differentiation. Based on past experience, the Allies will not be eager to treat Eastern Europe as an undifferentiated whole. Given the way the Allies tend to react to actions they perceive as increasing East-West tensions, it would be difficult for NATO to adopt and nearly impossible to enforce a policy of non-differentiation. Indeed, U.S. attempts to do so would exacerbate relations with our Allies.

European Economic Relations. It is also essential that West European economic relations with Warsaw Pact states are significant for these nations global trade, of crucial importance in some West European industries, and existed before the advent of communism in Eastern Europe. Well over forty percent of this trade of our European NATO Allies is with Eastern Europe, with the balance being with the Soviet Union. In consequence, any policy which would treat West European economic relations with Eastern Europe less favorably, in order to achieve a par with existing treatment of the Soviet Union, would collide with our Allies' national economic objectives.

Influencing the Allies. With regard to the instrumentalities of differentiation, Allied response to recent U.S. efforts on Poland demonstrated that the Allies can be brought along to support our policies. Careful planning and preparation, including advance consultations with the major Allies; appropriate consultations in various fora, including POLADS and NAC in NATO and in OECD; evidence of high level U.S. interest; realistic goals which take into account legitimate European interests; some well-timed prodding; and recognition of individual Allied actions in the direction of the unified response we hope to achieve are all elements in the formula for successful policy implementation.

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Importance of Consultations. The importance of continuous and meaningful consultations cannot be overemphasized, particularly when the U.S. plans policy initiatives that affect Allied interests. Springing a major policy decision, even one such as differentiation to which the Allies could be expected to be basically sympathetic, without sufficient preparation and notice is a virtual guarantee of resistance and resentment. This does not mean that we will always gain uniform support for our objectives nor will we necessarily wish to act in concert with our Allies on all occasions in our own interests. It does mean, however, that shared policy inputs and responsibilities, including incorporating Allied values, beliefs and interests into policy decisions, are prerequisites for strengthened Allied cohesion and Allied cooperation on specific policies.

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VI. REGIONAL ASPECTS

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The decision by the USG in the late fifties and early sixties to provide Poland with credits and generally more favorable economic treatment than we accorded the Soviet Union, together with the establishment of a number of cultural/scientific exchange programs, which have been continued and expanded under both Republican and Democratic Administrations, has had a major impact on that country's development. In fact, it can be argued that the special treatment given to Warsaw over the past twenty-five years -- which has included three presidential visits -- has had a major impact on reinforcing the somewhat pluralistic nature of the Polish system (e.g., private agriculture, the important role of the Church), while at the same time encouraging those forces which led to the rise of Solidarity and that country's brief, but vitally important experiment with greater openness and democracy.

Since 1956, U.S. economic ties with Poland, including trade, PL-480 funds and the granting of credits have expanded dramatically. For example, U.S.-Polish trade turnover grew from about \$250 million in 1972 to over \$1.2 billion at its peak in 1979. The United States has provided Poland with over \$2 billion in Commodity Credit Corporation (CCC) loans since 1962. Loans by the Export-Import Bank to finance U.S. exports of manufactured goods to Poland amounted to over \$250 million since 1972. Most of the Export-Import Bank's lending was for capital equipment which helped develop Poland's industrial capacity in areas such as foods processing, chemicals, metallurgy, and electronics.

Since 1956, The U.S. has provided Poland with a total of \$520 million in PL-480 food assistance in the form of local currency sales. Considerable sums of money have also been used for agricultural technical assistance and education in Poland. One result is the successful adoption by private farmers of modern U.S. developed poultry raising techniques.

U.S.-Polish economic ties -- despite their limited nature when compared with our Allies -- have provided the U.S. with important advantages. To begin with, the U.S. is in a position to block any chance for recovery of Poland's shattered economy by maintaining our refusal either to reschedule Poland's debt or to extend any new credit. These sanctions, together with the NATO decision to deny additional government-to-government credits to Poland until internationally recognized human rights are restored, have significantly increased USG leverage vis-a-vis the Warsaw government.

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The influx of U.S./Western technology has brought with it increased personal contacts between Polish and Western specialists and the need to train a significantly large part of the Polish elite in Western managerial techniques. This exposure increased the pragmatism and Western orientation of key segments of the Polish economic and industrial middle management and led to growing tensions between it and the more ideologically oriented party and government factions. Disaffection with rigid Soviet style economic management is widespread among key middle level technocratic and management cadres and in some cases extends to the upper reaches of the government and party. These groups are the core of the national consensus that formed around Solidarity demanding drastic economic reforms. The martial law regime has silenced these individuals for now but most remain in positions of authority since their regime must depend on them for the nation's economic well-being over the long-term. Their influence in the Polish hierarchy is likely to grow over time, and with it pressure on the regime to install a more market-oriented, decentralized economic system. It is strongly in our interest to support and cultivate these groups which are a natural constituency for Western views as well as a thorn in the party hardliners' side.

In the cultural sphere, the hundreds of U.S. cultural groups which have traveled to that country have helped reinforce the populace's pro-Western orientation. The same has been true of RFE/VOA broadcasts, which are viewed by many Poles as crucial sources of objective information, particularly in periods of crisis. U.S. exchange programs have also had a major impact, especially in the social sciences. For example, almost every single well-known Polish sociologist has studied in the U.S., and the same is also true to a lesser degree of historians and economists. Furthermore, most of Poland's journalistic elite has traveled to the U.S. at one time or another. As a result, Polish social scientists, and Polish journalists have tended to be significantly less ideological in their writings than is true of most of their Warsaw Pact allies.

Our strong ties with Poland have also had an important influence on Poland's human rights behavior. Poland's record on emigration has been relatively good, and Warsaw has been unusually tolerant--by Pact standards--of dissent. In both cases, Poland's actions have been influenced by our Embassy's constant prodding and reminders that Polish behavior in these areas will impact on our overall relations, especially in the economic area.

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Finally, while the policy of differentiation cannot be said to have led to the rise of Solidarity, it clearly played an important role by allowing, through U.S. policy, the greatest possible access to American thought and institutions.

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CONFIDENTIALB. THE GERMAN DEMOCRATIC REPUBLIC

Relations with the GDR, to a greater extent than our relations with most other Eastern European countries, are deeply interwoven with specific strategic and political interests of the United States in Europe. In most cases, the more usual aspects of bilateral diplomatic and trade relations are overshadowed by the important role played by the GDR in the overall geopolitical situation in Central Europe. This situation often limits what we can realistically expect to achieve bilaterally with the GDR. At the same time, it heightens the importance of expanding our understanding of the situation and of developing additional possibilities for exerting influence there.

-- A basic fact affecting the US-GDR relationship is that as one of the four victorious powers from World War II, the United States retains a share of ultimate responsibility for a peace settlement in Central Europe. Continuation of these "four power rights and responsibilities for Berlin and Germany as a whole" results in certain rights and practices of the United States which daily violate the GDR's concept of its dignity and sovereignty. The continual exercise of many Allied rights may damage the pride of the East German leadership, which lays claim to many of the same rights in its quest for power and legitimacy. Maintenance of these rights and the practice attached to them remains a primary American interest in Europe, thus establishing clear limits to the development of our relations with the GDR.

-- The most important operational imperative of these rights is the existence of West Berlin and continued Western responsibility for maintaining the freedom and viability of the Western Sectors. Since we hold the Soviet Union responsible for maintenance of these rights, we refuse to discuss Berlin matters with the GDR, even though the problems which arise are often of direct importance to East German interests and often arise as a result of calculated GDR actions. Equally as galling to the GDR is the fact that we refuse to recognize East Berlin formally as the East German capital, and that we continue to exercise special rights within East Berlin. Protection of our rights in Berlin as a whole remains more important to us than progress in bilateral relations with the GDR.

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-- Second in importance as far as American interests are concerned are the unique geographic and national situation of the GDR. As part of the former German Reich, the GDR occupies one of the most strategic areas of Europe. Its common national heritage with the Federal Republic provides a continuous source of potential instability and infection from the West. Whatever the state of "normal" US-GDR bilateral relations, we have an overriding national security interest in knowing as much as possible about the country and its leadership and in finding means of exerting as much influence as possible over its behavior. This basic interest will continue as long as the geopolitical balance in Europe continues to revolve around Germany and the "German question."

-- Our relations with the GDR must also take into account to a unique degree the FRG's natural preeminence and vital interest in matters East German. Inner-German relations are a matter of extreme importance and sensitivity with all factions in Bonn and throughout the FRG. Regardless of party affiliation, it is an article of faith for the vast majority of West Germans that the West should help lessen the division of Germany and that the FRG must pursue improved relations with the GDR as a means of lessening the hardships on fellow Germans behind the Wall. For us, this means the maintenance of "correct" relations with the GDR, taking care to avoid getting either ahead or too far behind the FRG.

This fact adds special importance to the West German commitment to maintain opportunities for progress in political relations with the GDR and Eastern Europe. Development of these political relations and expansion of humanitarian contacts with the GDR provide an outlet for German national concerns which might otherwise be expressed in more dramatic and destabilizing forms. It is thus in our interest to support FRG efforts to improve ties with the GDR, and to stay in step with Bonn in development of our own bilateral ties with the East Germans.

-- The GDR was a creation of the Soviet Union and remains almost totally dependent on the Soviet Union for its independence and existence. Its location on the front lines between NATO and the Warsaw Pact makes it a strategic asset that the Soviet Union is never likely to risk losing. The importance of the GDR to Soviet strategy insures that the Soviet Union will not tolerate any movement or development that might alter the GDR's political and strategic role. Nor would the East German regime want the Soviets to do so. Given this mutually-reinforcing need for each other, the prospects for the

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United States being able to encourage liberalization and greater independence internationally are limited. We should also keep in mind that given the importance of the GDR for both the USSR and the FRG, any sign of instability within the East German political system could have immediate, negative consequences which could damage broader U.S. interests in both East and West.

-- Finally, our leverage with the GDR is comparatively limited. We want far more from the GDR in concrete terms than the GDR wants -- or can expect to get -- from us. Aside from the Berlin issue, the GDR's primary bilateral goal is winning Most Favored Nation treatment for GDR exports in order to boost sales, since bilateral trade runs about ten to one in our favor. Unfortunately for the GDR, to get MFN treatment the GDR must first satisfy the Jackson-Vanik amendment's requirements on free emigration and settle over \$78 million in U.S. claims, as well as satisfying the private, international Jewish material claims of \$100 million. Though the GDR's treatment of its few remaining Jews is good, its overall emigration policy and the issue of unsettled claims present serious problems.

Emigration to the U.S. is not a great problem. About fifty East Germans apply to emigrate to the U.S. every year and almost all receive permission without inordinate delay. Emigration to the Federal Republic is entirely another matter, however, and the Jackson-Vanik amendment applies to emigration worldwide. Since millions of East Germans want to travel to West Germany where many of them would doubtless stay, the GDR sees restricted emigration as a matter of national survival.

As for claims, it will be hard for the GDR to find the means to settle. The GDR is short of manpower and almost entirely dependent on imported raw materials and energy. This mix has increased the pressure on the GDR to devote hard currency to the purchase of imported raw materials and energy. At the same time, the GDR must acquire Western high technology and equipment to maintain industrial productivity in the face of aging industrial plants and unexpandable manpower productivity problems.

Though there is consequently little possibility of major breakthroughs in bilateral relations, our policy of seeking practical solutions to non-ideological issues has been successful in a number of significant ways since relations were established in 1974. The GDR has bought hundreds of millions of dollars of U.S. grain each year and bilateral trade has run over ten to one in our favor. A Consular Agreement guaranteeing

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access to detained U.S. nationals was signed in 1979, and the GDR has fulfilled its conditions. The GDR agreed in 1979 to expedite the resolution of divided family and fiancée cases, a long-standing U.S. goal. The GDR's performance since then has been generally good.

The GDR also agreed to renegotiate the costly short-term leases we now have in East Berlin, provided the GDR could relocate its chancery in Washington.

These positive developments are balanced by continuing points of friction. GDR activities in the Third World, generally in support of Soviet efforts, pose serious threats to U.S. interests (Angola, Ethiopia, South Yemen, Central America). It supported Soviet intervention in Afghanistan with lots of words, some nonmilitary equipment, but no troops. It took a hard line against Solidarity and strongly supported the December 13, 1981 crackdown. It increased the amount of Eastmarks each Western visitor must buy per day in an effort to stem the flow of FRG visitors while maintaining the level of hard currency receipts.

On balance, however, it would appear that the policy of realistically tailoring our expectations and policy to what is possible has been advantageous to the U.S.

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SECRET/SENSITIVEC. CZECHOSLOVAKIA

The Husak regime has a well-deserved reputation for harsh repression of relatively modest internal dissent and rigid adherence to Soviet foreign policy positions. After more than a decade in power, the leadership remains insecure and lacks significant domestic support. Perhaps to a greater extent than any other regime in Eastern Europe, it has succeeded in securing widespread political apathy through outright concessions to the material wants of the population.

With Husak himself a one-time supporter of Dubcek and victim of the Stalinist purges of the 1950s, there were early Western hopes that under his leadership there might gradually evolve a more liberal system, as occurred in Hungary after 1956 under Kadar. These hopes have not been realized. The leadership has made no serious attempt at broad accommodation with those who supported the reform movement. It has declined even to try to reintegrate most of the technocrats expelled from positions after 1968, whose expertise the Czechoslovak economy sorely needs. The regime's response to any manifestation of dissent, particularly following the emergence of the Charter 77 movement five years ago, has been swift and harsh. Events in Poland over the past year have heightened the regime's insecurity and its vigilance. The leadership's handling of dissent, and its repressive image, have been an occasional source of embarrassment to other East European regimes and even to the Soviets in their dealings with the West.

The availability of the Czechoslovak government to maintain domestic tranquility by ensuring a continued rise in the standard of living is in question. The Czechoslovak economy, once second only to that of East Germany in Eastern Europe, is stagnating. There is a widespread feeling among the populace that the standard of living has begun to decline. However, given the relatively high standard of living Czechoslovaks already enjoy -- and the still conscious experience of 1968 -- this popular perception does not now constitute a political threat. Analyses of whether or when growing economic discontent might become politically threatening are necessarily speculative. The regime is sufficiently concerned about the economic difficulties facing Czechoslovakia to have undertaken modest steps to improve economic performance. It remains doubtful, however, whether this extremely cautious, insecure group of leaders could muster the political will to undertake

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the types of reform many believe may soon be necessary to stave off major economic deterioration. Lack of serious reform could lead to closer Czechoslovak integration with the Soviet Union and other CMEA countries.

US-Czechoslovak political relations -- and trade -- have been at a minimal level. U.S. influence in Prague, even on issues not directly affecting Czechoslovak interests, has been extremely limited. Recent resolution of the longstanding claims/gold issue has not led to an improvement in the substance or the atmosphere of the relationship (nor, given events in Poland, did we anticipate it would.) Antipathy toward the U.S., obsequiousness toward the Soviets, and internal repression do not reflect total unanimity of view among the leadership. However, among leaders all of whom must constantly bear in mind Soviet sensitivities, those whose fortunes are most clearly tied to Moscow have had a relatively easy task perpetuating US-Czechoslovak friction. Those potentially inclined toward a more moderate internal or external course have perceived too little incentive and too great a risk -- primarily to themselves -- to rock the boat.

Prague -- and Moscow -- fully appreciate that U.S. differentiation places Czechoslovakia near the bottom of the list. Moscow, at least, is content that it remain there. While there may be little we can do to alter the regime's political and economic dependence on Moscow, we should be concerned, from a policy standpoint, with how most effectively to increase the cost Moscow pays for Czechoslovak subservience. Given the poor state of U.S.-Czechoslovak relations, our mix of policy instruments with which to deal with Prague is severely limited. The most important among them will continue to be measures of "deprivation" (e.g., denial of MFN). Other than strongly to discourage private U.S. lending, there are few overtly "punitive" measures available.

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D. HUNGARY

Though consistently supportive of Soviet positions on major security issues, Hungary presents a unique case of a Warsaw Pact country which has gradually, and so far successfully, modified its policies to the point where they reflect a distinct shift toward increased ties with the West and its monetary system.

U.S. Interests: The record shows that differentiation has been a workable and positive policy in strengthening Hungary's Western orientation.

Strategic Benefits to the U.S. Gained From Differentiation: Hungary became part of the Soviet sphere against its will following World War II. Since then, the USSR has maintained up to 70,000 troops in the country to ensure its strategic interests and to protect its forward military posture in the area. The population remains fundamentally anti-Soviet and nationalistic and despite various economic reforms instituted by the Hungarian leadership over the past two decades, there have been manifestations of dissidence, some of which have been spawned by the events in Poland. Differentiation (trade with the West on non-discriminatory terms, intellectual and scientific contacts, etc.) has been a politically feasible way for the Hungarian leadership to channel the population's pro-Western sympathies and inclinations. For the Soviets, however, the Westward pull on Hungarians complicates the job of Soviet military planners.

Since the early 1970's, the Hungarian regime's emphasis on housing construction and on production of consumer goods has directly affected Hungary's defense posture. Between 1975-1980 Hungary spent the smallest proportionate amount of GNP on defense among the Warsaw Pact countries except for Romania. In 1980 it spent the lowest amount. Since 1981 military service has been reduced in order to alleviate the manpower shortage in various sectors of the economy; conscripts may be released after serving six months but must agree to fixed job terms or to complete their military obligation. Despite Hungary's professed fidelity to the Warsaw Pact, the USSR probably continues to harbor distrust of the Hungarian military which, to some extent, is not unmindful of the 1956 Soviet invasion of Hungary.

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Economic Benefits to the U.S. Gained from Differentiation: The Hungarian leadership's decision to shift away from the Soviet model and to decentralize the economy began after 1965 and sought to restructure Hungarian agriculture. Hungary's success in agriculture is based on the reduction of central administrative controls, the application of market forces in setting prices, production and investment levels, and the institution of economic profit incentives. These reforms could not have been achieved without a conscious decision by the country's political and technical leadership to use Western equipment, non-strategic technology and know-how. Hundreds of Hungarians learned their agriculture in Des Moines rather than Minsk, and dairy, meat and poultry production is based on the successful implementation of a Chicago firm's production system.

The notable improvement in the Hungarian standard of living has given Hungarians a greater stake in preserving and advancing ties with the West. It adds to internal pressures for faster liberalization and greater pluralism in the social as well as economic sphere. The economic reforms are oriented in a liberal direction. They have brought Hungary closer to Bonn, London and Washington, not to Moscow, Warsaw or Prague. And, because Hungary courts U.S. and Western business and finance, Hungary is particularly sensitive to Western CSCE concerns. Whether it is divided families, treatment of dissidents, travel to the West, or access by Western journalists, Hungary presents the best CSCE record of any Warsaw Pact country, with the exception of Poland before December 13, 1981.

Our policy of treating Hungary differently from other East European countries -- along with similar policies pursued over the years by our NATO Allies -- has encouraged and facilitated Hungary's drift away from economic dependence on the USSR and CEMA. By establishing various forms of linkage, we made it advantageous for them to reorient their economy (with attendant social implications) toward trade with the West. This transformation required familiarity and acceptance of U.S. and Western thinking, concepts, technology. It required readiness to open Hungary to more tourists, family visits, businessmen, religious leaders and political and cultural exchanges, e.g., the first crusade in Eastern Europe by an American religious leader (Billy Graham), the "America Now" and other exhibits with mass impact, cooperation in narcotics control (a voluntary decision to stop Hungarian production of methaqualone), and improved consular relations.

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Hungary's economic advances have created economic and political tensions within CEMA between the advocates of increased liberalization and the proponents of more conservative philosophies. Hungary's recent application for membership in the International Monetary Fund showed another independent step away from the Soviet economic grasp and toward a major Western financial institution.

A perceived change in U.S. policy, adverse world economic conditions and a drying up of Western credit sources in the wake of Poland now imperil the success of Hungary's economic reform program. So far, Kadar and other leading party officials continue to voice strong public support not only for the reforms but for their broader application. Clearly, however, if Hungary reschedules its debt and suffers perceptible reductions in its standard of living, it will cease to glitter as a reform model anywhere in the East. In Hungary and throughout the Warsaw Pact, anti-Western forces would be comforted. And, at least in Hungary, the failure of a fifteen-year economic reform program based on trade and contacts with the West would have adverse long-term effects that could only be contrary to U.S. interests.

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E. ROMANIA

The fundamental long term goals which the US has pursued in Romania since President Nixon moved to revitalize relations in the late 1960's have been to encourage and support Romania's efforts to extract itself from the grip of the the Soviet Union, which had thoroughly dominated it throughout the 1940's and 1950's, and to encourage a liberalization of its internal regime.

Our goals with respect to Romania are the antithesis of Soviet objectives.

Under whatever name, our policy of cultivating Romania's aspirations for greater freedom of action in the realm of foreign affairs, has worked to erode Moscow's influence and has increased our own. The process is complex, long-term, and marked with occasional set-backs and frustrations.

In differentiating among the countries of Eastern Europe we have looked to the degree of internal liberalization which has taken place or manifestations of a country's independence in foreign affairs.

Evidence of independence in Romania's foreign policy, whether in economic, political military or "straight" political realms, is readily apparent. Our support of Romania's efforts to gain greater freedom of movement within the confines of geography, membership in the Warsaw Treaty Organization (WTO) and CEMA has had, as stated, the two pronged aim of weakening Soviet influence and increasing our own so that we can pursue our other interests in political, strategic, commercial, human rights, scientific and other fields.

In our relations with Romania we have sought to act in concert with our NATO Allies. They, like we, are attempting to encourage Romania's relative independence through the expansion of diplomatic, trade and other contacts.

To the extent that any medium sized state caught up in the competition of two rival groups of states can act independently, Romania does what it does in foreign affairs largely of its own choosing. This naturally means that it will occasionally act contrary to our interests or in taking a nuanced position on a crucial East-West issue will seek to straddle the fence between us and the Soviets (e.g. the military take over in Poland.)

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Owing in part to the support provided by the US and the West, however, Romania has been able to pursue a foreign policy which more than in the case of any other WTO nation has either coincided with our own interests or has not coincided with those of the Soviet Union and the rest of the WTO. For example Romania:

-- does not permit the stationing of WTO troops on its soil and does not participate in WTO military exercises except at the staff level. Even then its level of participation is the lowest of any WTO state (16 percent in recent years).

-- repeatedly stressed it would not participate in a Warsaw Pact intervention in Poland were one to take place, just as it refused to join in the 1968 WTO intervention in Czechoslovakia (which Ceausescu publicly condemned at a mass rally in Bucharest).

-- was the only WTO state to criticize the Soviet invasion of Afghanistan and to call for Soviet withdrawal. It alone of WTO states refused to vote against the UN resolution condemning the Soviet invasion.

-- has consistently called for reduced military spending both in public and private. In 1978 Ceausescu drew the public ire of Brezhnev for his public statements to reduce military spending instead of increasing WTO military budgets as requested by the Soviets.

-- has sought, in an apparent effort to reduce dependence on the WTO, to diversify its source of supply for some major military components such as helicopters, transport and civil aircraft and even fighter aircraft.

-- has sought closer ties with the West on a variety of military related issues. It engages in regular exchanges with the US National Defense University. It welcomes annual US Navy fleet visits.

-- has taken a relatively even-handed position on the INF issue, supporting President Reagan's call for a "zero base" option, seeking to find common ground between the US and Soviet positions and urging successful negotiations in Geneva. Similarly Romania has consistently supported UN disarmament resolutions (many of which the Soviets have opposed).

-- alone among WTO states maintains diplomatic relations with all Middle Eastern countries; alone among WTO states supported the Camp David agreements, indeed played an instrumental role in bringing Sadat and Begin together.

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-- provided the link between Iran and Israel in the 1960's and 70's when the supply of oil to Israel was crucial to its survival.

-- refuses to recognize or even support the Soviet backed Vietnamese regime in Phnom Penh.

-- maintains excellent relations with the People's Republic of China (unlike other WTO states).

-- pushed at the original Helsinki Final Act negotiations for Confidence Building Measures, in defiance of the Soviet position; at Madrid, Romania's willingness to work with the West resulted in its regular exclusion by WTO nations from their caucuses on CSCE agenda items.

-- has made serious long-term efforts to increase participation in the Western economic structure and decrease its dependence on the Soviets and CEMA. It was the first WTO country to join the IMF and World Bank, and it has qualified for the GATT.

-- defied the Soviets and broke ranks with the other WTO and CEMA states to negotiate separate trade agreements with the U.S. (1974) and the EC (1980).

-- has diversified its trade and economic relations from a point in the early 1950's when it was dependent on the Soviets for nearly 90 percent of its trade to the point today where nearly 60 percent of its trade is with the West and Third World and less than 20 percent is with the Soviet Union.

-- has increased its level of two-way trade with the US from approximately \$350 million in 1974 to over \$1 billion in both 1980 and 1981.

-- is the only Communist state to support the Western position on the sharing of scientific data obtained from satellites.

-- was the first WTO state to accept the presence of an American Library open to the general public.

-- was the first WTO state to accept the terms of Jackson-Vanik with the result that more Romanians are approved for emigration to the United States per year than the United States is willing to accept.

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-- since 1962 has resisted Soviet initiatives to establish joint planning mechanisms and hasten integration within CEMA.

In sum, Romania is a country which, ever mindful of geography and the current geo-political realities, has nonetheless, with the support and encouragement of the West managed to assert a remarkable degree of independence in its foreign policy.

The area in which we have experienced the least relative success has been human rights (exclusive emigration.) This has been the most difficult area to achieve success. Human rights involves internal policies which are the most difficult to influence directly and which the Romanians are least interested in changing. Successes have been registered, however, as in the cases of Ababai, Prejban, Dascalau, Teodosiu, Goma, Georgescu, Crisan and Capusan, while limited success was achieved in the cases of Cana, Brasoveanu and the four Bucharest Baptist pastors. If some Romanian Christians are in jail for smuggling several score thousand Bibles through Romania to the Soviet Union, others, working quietly through legal channels with the support of the Department have succeeded in bringing smaller numbers into the country. Successes or failures in individual cases neither prove or disprove the effectiveness of differentiation with respect to resolving human rights cases in Romania. Progress in this area will require fundamental adjustments both in Romanian society and policy, and will take time.

Recent statements and actions by the Romanian leadership indicate the Romanians place significant stock in maintaining their options in the West. In order to do this Romania has sometimes found it necessary to act more in conformity with Western interests. MFN requires annual review of Romania's emigration and human rights policies and subjects it to constant pressure in these areas. IMF and World Bank membership require Romania to accept both the outside audit of its economic and financial activities and the imposition of requirements for systemic in the economic system.

The policy of differentiation with respect to Romania works in part because in one important area our policies coincide and are mutually supportive. Both of us wish to limit Soviet hegemony over Romania. A Romania fully integrated in the Warsaw Pact and firmly aligned with Moscow on all international issues would strengthen Moscow's hand in the region (and for the immediate future in the third world where Romania presently has extensive contacts). The policy of differentiation may also, over the long

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run, serve our interests in that area where Romanian and US interests do not coincide, the liberalization of the internal regime.

Our ability to have our voice heard and to make our influence felt, however, depends on maintaining a constructive relationship with Romania, and on Romania's being able to look to us as a nation on which it can depend. Over the past decade to decade and a half we have constructed a network of political, commercial, cultural and scientific ties as a result of our policy of differentiation. Now, when the issues are the hardest between us, is the time to make use of that network.

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SECRET/SENSITIVEF. BULGARIA

Bulgaria is one of the Soviet Union's most reliable and stable Warsaw Pact allies and its sole strong backer in the Balkans. Sofia's economy, political system and foreign policy are generally patterned after, dependent upon, and responsive to Moscow's preferences. While there have recently been some manifestations of Bulgarian nationalism, there is no indication that Bulgaria will alter significantly its basic policy of allegiance to the USSR. Some 75 percent of Bulgaria's trade is with the Soviet Union and Eastern Europe, including the bulk of its raw material and oil imports. The Zhivkov regime believes that its acceptance of Soviet political tutelage and economic largesse has helped it to ward off the political and economic upheavals that have occurred elsewhere in Eastern Europe. The Bulgarian population, which has shown little inclination for dissent, appears to be satisfied with a modestly improving standard of living and cowed by a regime which reacts ruthlessly to the slightest indication of unrest.

Bulgaria's 70-year-old President and General Secretary, Todor Zhivkov, has headed the Bulgarian Communist Party (BCP) since 1954 and is expected to remain in office for the foreseeable future. Zhivkov has in recent years permitted some clear manifestations of Bulgarian nationalism and allowed increased contact with the West in some areas. The regime has also instituted a program of limited economic reform, which would allow individual enterprises greater leeway in decision making. However, there is no indication of any appreciable, substantive change in Bulgaria's internal or foreign policy.

Bulgaria remains a Soviet loyalist on all foreign policy issues. Though its commentary on the Polish crisis was initially restrained, it eventually joined in the hard-line Pact chorus. Recently, via its proposals for a Balkan nuclear free zone and a Balkan summit, Bulgaria has tried, obviously with Moscow's blessing, to move the Balkans in an anti-NATO direction. Its anti-U.S. propaganda is intense and constant, notwithstanding the protestations of Bulgarian leaders who play this down in private and stress their desire for broader ties to the U.S. and the West. In the Third World, Sofia has expanded its political activity and military aid, suggesting the possibility that it could become a modest adjunct to the Soviet-surrogate roles of Cuba and East Germany -- especially in Africa and Central America.

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Bulgarian performance regarding the Helsinki Accord has been spotty at best. The Bulgarian Government has been generally unresponsive in areas of interest to the U.S. such as divided families and family visitations. In addition, the Bulgarian authorities have been uncooperative in efforts to halt the flow of narcotics to the West from the Middle East through Bulgaria.

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VII. APPENDIX

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APPENDIX: A. YUGOSLAVIA

This Administration has reaffirmed the U.S. policy of support for the independence, territorial integrity and national unity of Yugoslavia. This policy is rooted in an awareness of the benefits to American interests from our generous treatment of that country, and of the high political and possibly military risks were it to be discontinued or even reduced. We recognize the limits on our ability to influence the Yugoslavs, and the undesirability of attempting to draw them completely into the Western camp.

At the most basic level, Yugoslavia's loss to the Soviets in 1948 was and is the West's gain. We would not want to risk a reversal. Yugoslavia, by providing an example of an independent socialist state which has successfully (so far) made its own way between East and West, serves our long-term interest in encouraging other Eastern European countries to loosen the Soviet grip. In addition, we view a militarily capable Yugoslavia as a key element in preventing Soviet expansionism and hegemony in Southern Europe.

Beyond these important considerations, the U.S. has gained in other ways from the existence of a nonaligned Yugoslavia. Despite its reliance on Soviet oil, Yugoslavia has not hesitated to attack the Soviet invasion of Afghanistan and the Vietnamese takeover of Cambodia, nor to criticize interference in Poland. Yugoslavia has been a stalwart opponent within the nonaligned movement (NAM) of Cuban efforts to convert that organization into a Soviet rubber stamp. While we differ on many issues, Yugoslavia has been helpful to us in bilateral consultations and, when consistent with Yugoslavia's own position, has headed off or diluted international initiatives (e.g., the Soviet terrorism resolution at the last UNGA) unacceptable to us. On the bilateral level, American businesses and banks have benefitted from their involvement with Yugoslavia, and the U.S. continues to be the largest foreign investor there.

Yugoslavia's third world economic and political ties would not enable it to sustain its current relatively high prosperity or freedom of maneuver vis-a-vis the USSR, without Western economic and political support, and the availability of Western military equipment. Should the Yugoslav economy collapse, not only would Yugoslavia lose its appeal as an independent model,

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but it would suffer severe internal political strains and probably be unable to continue an active role in the NAM. At worst, events could lead to a return to the Soviet orbit. It would certainly mean a much more repressive and suspicious regime, and a leadership less inclined to be helpful to U.S. concerns. Thus, any significant downgrading of our relationship or failure to implement our commitments would damage U.S. interests while weakening Yugoslavia's position.

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SECRET/SENSITIVEALBANIA

Since its break with the Soviet Union in 1961 and with the PRC in 1978, Albania has pursued a course independent of the major powers. It has taken limited steps in recent years to strengthen ties (primarily in trade) with various West European and non-aligned countries. Internally, the Albanian Workers' Party continues to control rigidly nearly all aspects of life in accordance with the uncompromising Stalinist ideology of First Secretary Enver Hoxha.

There is no hard corroborating evidence for the widespread speculation that former PM Shehu's recent "suicide" resulted from a leadership struggle, let alone that it resulted from a struggle over the pace or direction of an Albanian "opening up". Factionalism in the Party is also difficult to substantiate. There is sufficient circumstantial evidence, however, that we cannot discount the possibility of ongoing jockeying for position in anticipation of Hoxha's eventual demise.

Given its strategic location, Albania could significantly affect security and stability in the Balkan-Adriatic-Eastern Mediterranean area. The primary U.S./NATO interest in Albania continues to be to prevent the re-establishment of Soviet political influence or of a Soviet military/naval presence. Such a presence would adversely affect NATO regional security interests and would pose a specific threat to Italy, Greece, and Yugoslavia (whose sensitive Kosovo region lies aside and is culturally and ethnically linked to Albania.)

Although Soviet overtures toward Albania continue, there is little likelihood of a positive Albanian response as long as Hoxha remains in power. But leadership changes loom nearer in both countries.

The U.S. has had no relations with Albania, directly or through third parties, since World War II. On several occasions, including quite recently, the U.S. has indicated publicly its readiness to consider establishing relations. Albania's attitude has been negative and there is no immediate prospect of change. Its public hostility toward the U.S. matches in vituperativeness that toward the Soviet Union.

Despite poor prospects for U.S.-Albanian relations, we have a clear interest in strengthening Western-Albanian relations in

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general, a major irritant in which has been the unresolved claims/gold issue. Albania is now the only country which has not received its allocation of recovered Nazi-looted gold from the American-British-French Tripartite Gold Commission. Delivery of Albania's share, now worth \$15-20 million, has been blocked for 30 years by unresolved U.S., UK, and Italian claims. Now may be propitious time to attempt to resolve this issue. We will soon begin exploratory talks with the UK, France, and Italy.

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